Bridging Austrian and Market Socialist Economics

Abstract:

Austrian economists and market socialists are not usually grouped together, in part because of their usual divergence on policy conclusions. However, Austrians and market socialists have much in common. Market socialists have concluded that central planning is not workable, and many of them have credited Mises and Hayek in this regard, although they have frequently not taken full account of the Austrian theoretical arguments. Austrians in turn have not often responded to market socialist critiques of the free market. After analyzing each school from the perspective of the other, I offer a proposal that rests upon both Austrian and market socialist insights, in an attempt to begin to bridge the vast policy divide.

Introduction

Economists of the Austrian school predicted many of the problems that were in fact encountered in socialist economies, and which market socialists recognize. Because they have had a vested interest in determining the best way to reach the goals that all socialists have advocated—greater equality and a reasonable standard of living for all persons, etc —market socialists have spent a great deal of time analyzing the problems with central planning, learning the benefits of markets, and working on ways to leverage the powers of the market system toward the ends that they seek.[1]

Seeing the significant failures of the model of central planning, market socialists have come to the conclusion that the use of markets is necessary. Market socialists recognize that the defects of state socialism or central planning include not only its inefficiency, but also its restrictions on freedom. Market socialists agree with Austrian economists about the dynamic efficiency of markets: it isn't the (chimerical) perfect competition of neoclassical economics that market socialists or Austrian economists care about. It is the decentralization of power and the information processing and allocative efficiency of exchange, which both market socialists and Austrians recognize markets provide but central planning does not.

However, market socialists also point to certain shortcomings of the market system when left free of government interference. In particular market socialists tend to agree that, while rewarding merit is a positive aspect of markets, markets are neither truly meritocratic, nor is meritocracy a perfect solution if they were. Market socialists point out other failings of the market: externalities and market failures. Austrian economists tend to deny all these failings.

Austrian Market Fundamentalism

Some purist laissez-faire Austrians, in particular Murray Rothbard and his followers, argue that there is nothing that government can do that would raise social welfare. If individuals wanted these goods and services they would buy them in the market, and they would be cheaper and their production more efficient. For some Austrians this even includes the services of property rights protection and law enforcement. Jeffrey Herbener, wrote in a paper (Herbener 1987) called "Austrian Methodology: The Preferred Tax

Type" that "It does not suffice to retort that the government provides services to the individual; so does the protection racket. The point is that the individual demonstrates that these services are not worth their opportunity cost when he chooses not to purchase them on the market."

This argument is based upon Murray Rothbard's theory of welfare (Rothbard 1956) which is formed upon a theory of maximization of "demonstrated preferences." However, the demonstrated preferences concept has a very obvious flaw: It ignores the distinction between *willingness to pay* and *ability to pay*. The concept of demonstrated preferences relies on the cyclical aspect of the market—that one is free to earn as much as she likes, and hence to consume as much as she wants and needs. Yet, even with full property rights and complete freedom, the cycle of earning and consumption remains incomplete so long as there are natural or luck-based discrepancies in earning power, most obviously among those who are not capable of working at all.

Hence, the Rothbardian conclusion regarding demonstrated preference is unwarranted. It is clearly wrong for Herbener to say of a sick or mentally ill and indigent homeless person that he does not want the government to provide him housing, a wheelchair, food or other help on the basis that he has already demonstrated that he does not value these goods and services more than their opportunity cost by not purchasing them in the market.

This critique extends beyond the Rothbardian notion of demonstrated preference and social welfare maximization of the market. More broadly, the Austrian assumption of consumer sovereignty and the entrepreneur guided by market prices and profit falls short where the consumer is incapable of expressing demand because he is incapable of working. For example, profit will not induce entrepreneurs into the wheelchair business or to care for the chronically ill if the individuals who would demand these goods and services cannot afford to pay for them.

Taking this argument a step further, the luck of birth and other accident magnifies and sometimes determines the level to which each individual is able to work and earn, and hence his power to demonstrate his full range of preferences in the market; therefore "demonstrated preferences" is a heavily weighted indicator, revealing the "votes" of the lucky many times, and those least lucky not at all. The market will also reflect the preferences of those who *choose* to earn more and spend more over those who choose to spend their time with charitable work or subsistence living. On the one hand it makes sense for the market to best reflect the preferences of those who actively engage it; on the other hand, this means it will perpetuate preferences and fill desires of those who put pecuniary interests above other considerations when it comes to choosing where to work. Is this really a system that can be said to maximize the welfare of the people relatively equally?

Furthermore, this effect will tend to be magnified. If the market is slanted or tilted toward the lucky and the active participants, this outcome also affects market participants' preferences. Individuals are influenced by what those around them purchase, but also the prices and availability of goods is determined by what the most active producers and consumers have already purchased. This in turn may also affect the preferences of individuals. This is another aspect of the market process that Austrian economists tend not to account for, despite modeling many evolutionary attributes of markets.

Preferences are not fixed but mutating, and influenced by the system itself. Market socialists have long argued that if markets create the demands that they then proceed to satisfy then the argument is actually circular. This endogenous cycle of the market acts as a multiplier of the preferences that “win” in the market. The most powerful and lucky individuals in the system—the strongest market participants—affect the market with their preferences (e.g., for televisions), the system affects the other market participants (inducing them to supply televisions), which in turn affects the system further, multiplying the effect of these dominant preferences. The voices of the weak, unlucky, and materially disinterested are further drowned by this process.

If the market system affects preferences endogenously and there is less expression of the sick, elderly, temperamentally non-acquisitive, and those who care most deeply for them; and meanwhile the more acquisitive members are able to first compound their earnings through investment, and then multiply their effect on the market by influencing preferences; then they will exert a disproportional effect on the market. The market may be heavily lopsided, reflecting the preferences mainly of the few most acquisitive members of society.

If demonstration of true preference is improved by, for example, income supplement for those without earning capacity, and other adjustments for luck-determined earning potential, then arguably even if this system also produces a lower total output per capita, it might better fulfill the true preferences of society. For this reason, one cannot deduce the relative level of welfare between two systems or policies based solely upon the level of GDP per capita in them.

There is also a welfare argument that can be derived from the diminishing marginal utility of money; especially near the necessity-level. In the Austrian conception, the concept of marginal utility is rooted not only in the idea that the seventh slice of pizza that you could purchase would be less desirable than the first, but also that the first need that we fill with our limited resources is the most important need; the second need is the second most important, and so forth. This reveals a point with which market socialists would agree: the marginal utility of the millionth dollar of annual income is going to be lower than the marginal utility of the first dollar. Austrian economists may reply that one cannot compare utility between two different individuals—although the marginal utility of my millionth dollar may be less than of my first, this says nothing about how it compares to the marginal utility of your first dollar—however this does not seem to square with Austrian Carl Menger's (Menger 2007) observation that for all of us the primary needs are *primary human needs*. It is a difference between the "satisfactions of greatest importance to men" and those which offer "merely a higher degree of well-being."

The same process, Menger goes on to explain, occurs with the satisfaction of specific kinds of goods; for example, while shelter is needed, and additional room is desired, there is a point at which ever-larger housing becomes a matter of indifference, and then even a burden. For some kinds of goods, the reason for diminishing marginal utility is simply because we view the use of the good in time: the seventh slice of pizza which has less value does so because it is not for consumption a day or a week later but now; the diminishing value of iron because a given project requires no more, etc. However, this would still imply that the utility of one person with a large amount of unspent money would be diminished less by loss of some portion of it than would be the utility gain by a starving child to whom the money was given.

It would be easy to taker this concept too far by, for example, calling for the equalization of incomes. First, even if basic needs are always higher than other needs, this does not mean that utility would be maximized if all incomes were equal: some people would value other needs more highly than other people would. Even if one determined that all marginal utilities were identical (which is highly unlikely), and therefore equalizing incomes would “maximize utility,” (1) there would be extreme problems of implementation, and (2) this consumption utility would not represent real welfare—for example, what if equalization entailed a loss of freedom?

Furthermore, money beyond that which is necessary to satiate basic needs is not used exclusively for personal consumption. If redistribution is costly, allowing the wealthy to invest and share their excess income may actually raise the utility of the poor compared to a program of government transfers (because of the waste of implementation). Market socialists often take this insight too far, but it is nevertheless real.

For all of the above reasons, market socialists have argued that the market should be supplemented. It should not be replaced by central planning because, despite its flaws, the market system is far superior to central direction. Yet, alone it is not optimal, and some intervention may improve it. The extent of that intervention is widely disputed within the market socialist school, and will be the subjection of discussion below.

Austrian analysis and market socialist propositions

The Austrian economic school was the only modern school to predict and explain the problems of calculation in a socialist society, and to apply the implications of this to government intervention in markets, as well for use in analyzing the benefits of markets and market competition. Although market socialists have taken many lessons from the experiment with central planning, and have cited Austrian economists in this regard, they sometimes rely upon neoclassical economics for their critique of markets and their predictions of the benefits of government intervention.

There are strong Austrian arguments against many market socialist proposals based upon the same analysis that warned against central planning, and which remain relevant even given the lopsided nature of market welfare fulfillment. A particularly important one regards certain proposals to socialize all capital goods or all large corporations. Although Ludwig von Mises famously argued that market prices in free capital goods markets were necessary for a functional economy, many market socialists argue that eliminating capital markets, or at least severely restricting capital ownership, is central to a market socialist option. Some market socialists have considered the Austrian arguments, and quote Mises or Hayek in their work (some, like Roemer (1994) and Burczak (2006), actually shape their own proposals on the basis of the Austrian arguments). However, others still argue for complete elimination or extreme attenuation of capital ownership without addressing Mises' calculation arguments; for example Plant (1989) and Pierson (1995); Burzcak (2006: 143) discusses the absence of prices in a proposal put forth by Michael Albert and Robert Hahnel.

Although many market socialists advocate some amelioration of capital goods ownership, but there is a broad spectrum of opinion on this topic. Pierson (1995: 99-100) summarizes four basic positions with regard to the ownership and management of capital goods by market socialists:

1. *The Libertarian position* socialism implies no more than equal entitlement to the means of production, with the question of how people choose to use their endowments left entirely open.
2. *The Social Democratic Position* capitalist forms are an acceptable component of socialism provided that the state uses its powers of taxation and regulation to correct income deficiencies and so forth.
3. *The Codetermination position* the respective rights of capital and labour in the enterprise should be redefined in the form of a capital – labour partnership, with each party being allocated a pre-determined share of profit.
4. *The Workers' Co-operative position* enterprises in market socialism should normally take the form of workers' co-operative, with capital supplied externally and entitled only to earn interest.

A basic income (to purchase a portfolio of stocks) given to each citizen might be an example of a libertarian market socialist proposal for redistribution of the value earned from capital goods. Although such a proposal may face problems, it would not suffer from the consequences enumerated in the Austrian critique of common ownership over capital. Other market socialist proposals do. John Roemer, who explicitly addresses Hayek's critique of socialism in the formation of his proposal, offers a model that is probably closest to the Worker Co-operative position, taking it farther than what is described above.

Roemer defends his solution on the basis, for example, that it surmounts the planning problems of centralized investment by only modifying interest rates, which he argues suffer from problems of market failure in laissez-faire economies and are therefore safe to tweak. Hence he accepts Austrian analysis of central planning, but answers Austrian critiques of market socialism using a (non-Austrian) neoclassical framework. Austrians would predict severe problems of calculation and distortion in Roemer's model; centralized determination of interest rates underlies Austrian Business Cycle Theory, and Roemer would advocate far more extreme adjustments than have previously been made. Yunker (2001) relies heavily on neoclassical methodology for his critique of the market, but does address certain arguments made by Ludwig von Mises that applied to his market socialist proposal. David Schweickart proposes a market socialism which completely eliminates the stock market and replace interest paying to private individuals with a general capital tax.[2] Market socialists should know better than to propose such solutions. In the Soviet Union a capital charge was introduced (similar to Schweickart's tax), and this was not an adequate solution (Nell 2010). One of the central lessons of the experiment with central planning was that resource allocation without a capital market is highly inefficient.

Other market socialists offer proposals that attempt to walk a line between full socialization of capital and simple redistribution of capital income (see, e.g., Bardhan and Roemer (1993)). In some of them workers manage or own large firms, while in others investment funds are managed by the state, or shares are tradable but not saleable for cash. Although some of the problems with centralized investment may be surmounted by such schemes, they may still fall prey to some relatively serious Austrian criticisms of intervention (such as price distortion or knowledge problems). However, if the only intervention taken was a very generous, but highly (market socialist) libertarian, income redistribution scheme, Austrians and market socialists might find common ground.

Bridging Austrian Economics and Market Socialism

Demonstrated preferences in the Rothbardian tradition is a flawed basis for determining welfare in the free market. Individuals do not start off equally or have equal earning potential, and some have no earning potential whatsoever but still quite obviously have preferences. Therefore, maximization of welfare requires that preferences of necessities be filled for all before the less-valued preferences for luxuries are filled for a minority. Furthermore, the concept of demonstrated preferences fails to account for the shaping of preferences by the market environment. Although the market appears to fulfill preferences well, these considerations indicate that redistribution may be necessary and efficient for optimal social welfare.

Obviously, if the standard is equal earning potential, one could quickly be led to equalizing scenarios such as those in Kurt Vonnegut's short story, *Harrison Bergeron*, such as weighing down the legs of ballerinas, and shooting pain into the minds of intelligent men. In fact, some market socialist discussions (for example, Abell (1989)) are reminiscent of this. Yet, taxation, and income support or vouchers could play this role instead. Although we cannot know all preferences, as is required for central planning[3], we can know basic necessities referred to by Menger.

Of course, if the state attempted to provide these necessities for all persons it could cause known problems that Austrians and market socialists both have cited: uniform provision for a complex product and changing demand, lack of competition and consumer sovereignty that comes with public ownership, and the inability to know the appropriate amount to produce or how best to produce the goods. However, an income support or voucher scheme would avoid issues of public ownership and public provision, as well as the main distortions that Austrians find in interventionist policies. Instead, increasing the purchasing power of the disabled would represent a *correction* of the market.

Implementation of such a scheme may still pose practical hurdles. How could a government determine who should receive income support? If only the most unable to work receive income support, this might fall well short of correcting the market's lopsided provision. However, it would be impossible to determine who beyond these few should receive support, and selectively offering support to a greater number would create incentives for "undeserving" individuals to change their behavior, if in fact there are such categories as "deserving" and "undeserving," which is a questionable hypothesis even in theory. Furthermore, those who receive income support may choose to spend it in such a way as to actually reduce their earning capacity, for example by spending it on drugs, holidays, or dangerous recreational activities.

For these reasons, the most appropriate sort of solution may be to provide all adults with vouchers for basic necessities, redeemable only through documented purchases, plus additional support for the highly disabled or sick. For example, the current market price for a median rent[4] or monthly mortgage ($700), basic groceries[5] ($200), and health insurance[6] ($600) comes to approximately $1500. For a smaller portion of elderly, disabled or ill, vouchers could be provided at a higher level, which could be determined on a case-by-case basis.[7] Additionally, educational vouchers could be provided.[8]

By providing every healthy adult with the same level of income support, the many complications of choosing who is worthy and what is fair are eliminated at one stroke. Providing only the highly disabled or sick with further support reduces the bureaucracy involved in determining appropriate levels of support for the needy to a tolerable level. Vouchers for necessities instead of cash offer at least two further advantages. First, there is far less chance that the resources will be spent on destructive activities that further reduce earning capacity. Second, the correction of the market toward greater production of necessities, especially the necessary health care for the disabled but also the necessary housing, food and medical care for those with lower earning capacity, is guaranteed. This would ensure that individuals have their primary needs met and free any additional income of low-earning individuals to fill secondary (but still relatively important) preferences.

This may sound like a very expensive scheme, and one which would entice many out of the labor market. However, there are a few things to consider. First, if this were to replace the current set (for example in the United States) of welfare programs, social security, Medicare, subsidies for certain kinds of business, tax credits, and other kinds of intervention, it would actually represent a very cheap solution that could be funded with a low flat tax. For 300 million individuals, the annual cost of the monthly $1500 of vouchers would be $450 billion; add to this amount vouchers for the disabled and a budget for education vouchers, and it should still sum to less than is currently spent.[9] The

U.S. "human resources" budget, which covers Medicare, social security, education and welfare, came to about $1.75 trillion in 2007.

Second, there would be two counteracting forces that would affect the dynamic cost: the exit from the labor market of those pleased with a monthly income capable of covering only bare necessities, and the growth effects of eliminating all of the current interventions and public sector firms, and replacing the current convoluted tax and subsidy system with a low flat tax.

As far as the first is concerned, the monthly subsidy of $1500 is similar to the current provision by the British government, once housing benefit, unemployment insurance ("dole"), and medical care through the NHS are considered. Although these benefits do likely reduce labor market participation, and long-term unemployment is higher in the UK than the US, labor market participation overall is not significantly lower.[10] Furthermore, some part of the lower participation in the UK and Europe, compared to America, is probably due to labor market rigidities (Siebert 1997). There also may be some benefits to a reliable source of income between jobs (Sjöberg 2008).

Importantly, there would be no effective marginal tax due to the proposed income support program because it would not be lost once paying work was undertaken. Although many individuals remain "on the dole" in the UK for long periods, without actively looking for work, many do work part time and might work more if they did not have to report the work and lose their benefits when they did. A law review article (Mackinnon 1995) makes this case, arguing "An alternative [to unemployment insurance] would be a universal (non-targeted) guaranteed basic income scheme under which all citizens receive a standard sum to which they can add income without penalty, which, despite an impact on the market economy, would be preferable insofar as it would be less likely to create poverty traps and a low paid underclass."

Surely the growth effects to eliminating the almost endless jungle of taxes, subsidies, and credits would be enough that a basic income scheme would represent a vast improvement over the current system.

Conclusion

Market socialists represent the economists who have taken the Austrian arguments against central planning most seriously. Unlike Austrian economists, market socialists continue to argue for sometimes radical interventions to correct perceived inequities in a pure laissez-faire economy. Some of these proposals are still subject to Austrian criticism, but others may actually correct the market in ways that clear-headed Austrian analysis can support. The distinction between willingness to pay and ability to pay has been ignored by many Austrian economists. When taken into account, and joined with other insights that Austrian economists and market socialist economists agree on, this insight points toward potential policy solutions that the two schools might agree upon.

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[1] Nell (2010) summarizes ten economic and policy lessons from the Soviet experience. The only other analytic exploration of specific Soviet policies, lessons from them, and application to theory and policy that I am aware of is Berliner (1993), a prominent Sovietologist writing about lessons regarding technological innovation from the Soviet experience and their potential relevance for market socialist economies, an essay that appears in *Market Socialism: The Current Debate*. However, the lessons may have been incorporated by mainstream economics without such a rigorous and explicit treatment; see, for example, Ellman (2009).
[2] "In Economic Democracy there is no stock market, for there are no stocks. The capital assets of the country are thought of as collective property, but they are controlled by the workforces that utilize them. That is to say, each enterprise is run democratically, with workers legally empowered, one person, one vote, to elect the enterprise's management. …Worker self-management is the first defining feature of Economic Democracy. The second feature…is its mechanism for generating and dispensing funds for new investment…. [Instead of savings] Economic Democracy relies on taxation. Each enterprise must pay a tax on the capital assets under its control. (This tax may be thought of as rent paid society for access to the collective property of society.) Economically this tax functions as an interest rate on capital—and thus obviate the necessity of paying interest to private savers. Generating the investment fund by taxing enterprises rather than by "bribing" individuals to save not only shuts down a major source of capitalist inequality, namely interest payments to private individuals, but it frees an economy from its dependence on the "animal spirits" of savers and investors." (Schweickart, Lawler, Ticktin, Ollman 1998: 17)
[3] Market socialists and Austrians agree that all human needs and wants cannot be known to a central planner. For example Miller (1989b:39) argues that,
"[T]he idea of universal human needs is not entirely bogus: clearly there are prerequisites which all of us must have to survive and flourish, such as adequate food, protection from the elements, and so forth. But such a list is not going to be very extensive, and, more important, the more affluent a society becomes, the smaller a proportion of its output will be required to cover these items. … If the critic tries to extend the list of universal needs beyond the basic essentials, he can be charged with arbitrarily attempting to impose his preferences on others who do not share them. For the fact is that people have very different ideas about how life should be lived beyond bare survival, and so their priorities in terms of goods and services they want to have also vary greatly. Rather than attempting to impose spuriously uniform needs on individuals and societies, we should be trying to create an environment in which the most diverse styles of life can coexist harmoniously."
Austrian economists would certainly agree with that sentiment. Note that he admits of a certain limited set of necessities which all humans do need: food, shelter of some sort, and one might add, basic health care or health insurance.
[4] The US Census lists the median rent for the year 2000 as $600, and the Global Property Guide lists the 2009 median rent at $680. See,
http://www.census.gov/hhes/www/housing/census/historic/grossrents.html
http://www.globalpropertyguide.com/North-America/United-States/Price-History

[5] Official USDA food plans: cost of food at home at four levels, U.S. average, April 2004, adjusted slightly up for inflation. See,
http://findarticles.com/p/articles/mi_m0EUB/is_1_16/ai_n6206921/

[6] The Medical Expenditure Panel Survey lists "Family-level out-of-pocket expenditures on health insurance premiums, among nonelderly families, by insurance status and family size, United States, 2006" As all of these numbers are for a single individual, I'm using the individual private premium rate of $566, adjusted slightly for inflation.
http://www.meps.ahrq.gov/mepsweb/data_files/publications/rf29/rf29.shtml
[7] Medicaid costs about $350 billion per year; this might suggest the ballpark figure for offering medical care for the chronically ill, disabled, and those unable to work enough to afford insurance or who have expensive preexisting conditions. However, vouchers arguably might be cheaper than the bureaucratic Medicaid program.
http://www.stateline.org/live/ViewPage.action?siteNodeId=136&languageId=1&contentId=16625

[8] $91 billion is currently spent on combined education services in the US. $70 billion is spent in the UK for all pre-school, primary, secondary and tertiary education for a total population 61 million population. Scaling up to 300 million in the US, this would be about $350 billion.
See the United States Federal Budget Outlays By Superfunction And Function, available here:
http://www.gpoaccess.gov/usbudget/fy10/hist.html
And http://www.hm-treasury.gov.uk/d/pesa09_chapter5.pdf

[9] $450 billion added to $350 billion as a generous estimate for the disabled and chronically ill, plus a very generous $350 billion allowance for schooling from cradle to college, would still only total $1.15 trillion.
[10] Organization for Economic Cooperation and Development (OECD), Directorate for Employment, Labour and Social Affairs, Key employment statistics:
http://www.oecd.org/document/53/0,3343,en_2649_39023495_42788213_1_1_1_1,00.html
(last accessed August 2010)