

*Whither socialism?* By JOSEPH E. STIGLITZ.  
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There is little doubt that Joseph Stiglitz ranks in the elite of theoretical economists. Nor can there be much doubt that the collapse of state socialism throughout Eastern and Central Europe, and the former Soviet Union in the late 1980s ranks as one of the most significant political/economic events to have occurred in this century. Thus, the meeting of a keen economic mind with a supreme economic/political problem promises much to the reader. *Whither Socialism?* accomplishes many things throughout its pages, but what it is unable to accomplish is perhaps the most telling. Stiglitz' book, despite its high promise, does not provide the reader with any new and bold conjectures on why state socialism collapsed nor does it provide much more beyond the usual platitudes about how one could maneuver the path from "here to there." But the promise of the book does serve to open the reader up to the real contributions that Stiglitz has to offer in terms of the information-theoretic revolution in economic science. In fact, perhaps the disappointment here is that the author accomplishes too much in this regard and not enough in the analysis of socialism and the transition despite the apparent obvious connection between the two programs.

The book can be usefully read as a survey

of the main results of Stiglitz' impressive research program in information-theoretic economics. These contributions add up to a formidable challenge to the Arrow-Debreu model. The author's critique of the standard model is thorough. Information is never perfect; competition is real, not perfect; and in a world of imperfect information and real competition the two fundamental welfare theorems of the Arrow-Debreu world no longer hold. Furthermore, the world of imperfect information and real competition corresponds in a more direct manner to the real world of business and economic life. Asymmetric information, strategic behavior (principal/agent problems, moral hazard issues, and adverse selection), are omnipresent in the organization of modern economic affairs. Theories which fail to appreciate this are doomed as the basis for models that will help us understand real world behavior.

The Arrow-Debreu model and the Lange-Lerner model are the two foils with which Stiglitz contrasts his own theoretical perspective. As he states repeatedly throughout the book, the Arrow-Debreu approach fails to capture essential characteristics of capitalism, and because the Lange-Lerner model of market socialism was built upon these Walrasian foundations it also failed to capture essential characteristics of the economic problem that must be solved if market socialism is to work reasonably efficiently. In fact, if the Arrow-Debreu model did reasonably capture the essence of efficient resource allocation in a market economy, then the Lange-Lerner model would provide an accurate picture of how to organize rationally a market socialist economy. In both cases, reality defies the model in a fundamental way.

The main thrust of this argument, of course, is not original to Stiglitz. Hayek made this argument repeatedly throughout the 1930s and 1940s in his various contributions to the socialist calculation debate (see, e.g., Hayek 1948). But the underlying reason for Stiglitz' argument is different. Whereas Hayek argued that the standard model *underestimates* the informational role of *disequilibrium* prices, Stiglitz argues that the standard model *overestimates* the functional significance of *equilibrium* prices in ensuring

Pareto efficient resource allocation. As Stiglitz states:

Market socialists were misled by the Arrow-Debreu model into thinking that they could get all of the advantages of the market economy simply by using the price system. (p. 138)

Hayek, on the other hand, emphasized that the standard model failed to understand the role of relative monetary prices in dynamic competition and, thus, served as a poor guide for public policy. Parametric prices failed to address the multiple information-relevant functions that real prices perform in directing human behavior, allocating scarce resources, and guiding production processes.

Stiglitz invites the comparison to Austrian economics (and Hayek in particular) throughout the book as he understands that his critique of the perfect information model is somewhat Hayekian, and yet he also knows that the implications he derives concerning the inefficiency of market allocations is "quite at odds with the Austrian tradition" (p. 43). He even includes a section in the book entitled: Hayek versus Stiglitz (pp. 24-26; also see pp. 6, 282 n. 11). As John Roemer (1995) has observed, while *Whither Socialism?* poses as a critique of market socialism, it is actually a thinly disguised anti-Hayekian manifesto. But Stiglitz fails to address Hayek's argument. In fact, he mischaracterizes it, arguing at one point that "Innovation played no role in the markets/market socialism debate, just as innovation plays no role in the neoclassical paradigm" (p. 139). True, innovation is a "black hole" in neoclassical theory. But that was precisely part of Hayek's argument in the 1940s. Real competition is a discovery procedure (hints of this mature Hayekian/Kirznerian theme were already evident in Hayek's critical review of Lange and Dickinson, see Hayek 1948, p. 196).

Stiglitz' problem is not limited to a weak reading of Hayek. He unfortunately cannot resist the temptation to characterize his opponent's position in the most simplistic manner possible: the insights of Ronald Coase, the Chicago/UCLA "New Learning" in industrial organization, and property rights theory in general are all dismissed as lacking argumentative weight—at one point Stiglitz even

quotes himself from an earlier co-authored article making the summary statement that while this line of research "may have been well funded, [it] was not well founded" (p. 120). His dismissive treatment of market-oriented arguments and his complete refusal to deal seriously with public choice arguments (the book contains no cites to Buchanan or Tullock) undermines his central concern—which is "the mix and design of public and private activities" (p. 25).

The Austrian and public choice questioning of government management of the economy can be seen as representing two sides of a coin. Both neoclassical arguments for market socialism and market failure theory were made from positions which assumed either benevolence or omniscience on the part of public sector officials. The Austrian argument challenged the assumption of omniscience, whereas the public choice argument questioned the assumption of benevolence. Both arguments must be addressed if an intellectually rugged argument for the mix and design of public and private activities is to be offered. Unfortunately, the complex set of institutions which form a "market economy" as compared to the set of institutions that permeate "socialist regimes" or "welfare state regimes" are never contrasted in Stiglitz' book in the manner which would truly enable a satisfactory comparative institutional examination of public and private economic activities.

With regard to the transition issue, Stiglitz informs the reader about the role of financial institutions and corporate governance (he is particularly impressed with the Japanese banking system), doubts about the importance of private property for enhanced economic performance, importance of real competition for informational and incentive reasons, warns of institutional inertia, admits that there probably is a connection between economic privatization and the political transition, and advocates throughout a central role for the state in the economy. Moreover, though we are told in conclusion that while the traditional socialist answer to the question concerning the proper balance between private and public can be judged a failure due to incorrect (or at least incomplete) economic

theory, the values which inspired the socialist answer are eternal. Can the insights of modern economics, Stiglitz is asking himself, be used to inform a policy mix that is consistent with the utopian ideals of a more humane and egalitarian society? His answer leans toward the affirmative, others would beg to differ, or at least offer an alternative vision of a more humane society (but Stiglitz does not really engage alternative social philosophical perspectives—even in a chapter entitled “Philosophical Speculations”).

Despite my reservations, *Whither Socialism?* is a fascinating book. It challenges the reader to explore the implications of imper-

fect information and strategic incentives, and, thus, sets the theoretical stage for a renewed professional appreciation of the power of comparative institutional analysis for understanding the worldly affairs of political economy.

PETER J. BOETTKE

*New York University*

#### REFERENCES

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