Whither Socialism?

Joseph Stiglitz


Why did socialism fail so badly, and, perhaps of more relevance to professional economists, why did our discipline not provide more insights into its failures? Joseph Stiglitz provides his answer to those questions in this volume. It represents a significant work in that it summarizes quite well neoclassical economics and its failure to provide much substantial guidance on the important question of the choice of economic systems. Stiglitz also argues that the “advice it did provide was often misguided” (p. 3).

Stiglitz, a prominent theorist, suggests that there are several problems with the neoclassical model. As formalized by Kenneth Arrow and Gerald Debreu it is seriously deficient in that it assumes perfect information. Although this assumption allows the precise specification of the conditions under which markets produce efficiency (how and when competitive equilibrium is Pareto efficient), this constrained maximization approach is misleading. Because of its incorrect characterization of a market economy and its misrepresentation of the ways in which markets solve problems of resource allocation, many were led to believe that market socialism could replicate the efficient results of markets.

However, the problems of social coordination are deeper and more complex than those represented by our constrained maximization models. Information is not free and the ways in which it is generated and communicated are far more involved than our models imply. Prices are more than a simple vector of one-dimensional tradeoffs and the meaning of competition in the neoclassical model is too narrow. The issues of decentralization versus centralization are not well treated by the standard economic paradigm and there is no place for innovation in the Arrow-Debreu model.

Stiglitz develops in considerable detail each of these points and discusses both the shortcomings of the neoclassical representation of markets and the reasons for the failures of market socialism. He also provides some brief philosophical speculation on the deeper reasons for the attraction of the Marxist ideology.

Since Stiglitz believes our standard paradigm has been so misleading for socialist economies he offers several tentative recommendations for the transition process. Considerable emphasis should be given to encouraging
competition among enterprises, and not just the price competition that is emphasized in our models of perfect competition. He also discusses the importance of establishing and enforcing the rules of the game and making binding commitments (difficult to do in democracies) to reform. He suggests that the threat of renationalization can hinder the effectiveness of privatization programs. Other fairly standard recommendations are included; the importance of macrostability, the creation of appropriate corporate governance when privatizing, and the relevance of justice considerations in the transition process.

The book is an excellent overview of the theoretical economic literature and its development over time and Stiglitz is a trenchant critic. He also offers, at the end of the book, some moral insights that should be welcomed by the Christian economist in that they go beyond much of the standard economic thinking that treats ethical and moral concerns as irrelevant.

However, the book is also somewhat maddening to read in that it ignores so much of the recent developments in economics that shed light on the very issues that Stiglitz is concerned with. The Austrian tradition has been a prominent source of criticism of the standard neoclassical model and its unrealistic assumptions about information. Stiglitz dismisses these criticisms because the Austrians “fail to develop formal models of the market process” (p. 24). Such short shrift is given to the Austrians that Hayek’s famous article, “The Use of Knowledge in Society,” is not even cited. Neither is George Stigler’s 1961 piece, “The Economics of Information,” despite the fact that Stiglitz claims to be tracing the development of the profession’s understanding of the role of information. The works of Harold Demsetz, Armen Alchian, and Steven Cheung are also largely ignored. The development of the theory of the firm by these individuals (building on the earlier work of Ronald Coase) has provided important insights into the very issues that Stiglitz thinks are crucial. There is also not a single reference to the work of Douglass North, and no acknowledgement of the Public Choice revolution.

One can also gain some insight into the limited perspective of Stiglitz by looking at the journals that are cited. There are only three references to articles from The Journal of Law and Economics, surely one of the major journals that has dealt with the focus of the book, namely organizations and institutions and how they develop. In fact, of the 322 references in the bibliography, 128 are to Stiglitz’s individual or joint work. Although such a prodigious output is impressive, the volume definitely suffers from a “not invented here” syndrome. The author seems see all developments in economics as flowing through his research and numerous times goes to some length to point out how he, and he alone, saved the profession from its own errors. Because so much of the book centers on Stiglitz’s own work, a more useful bibliography of important contributions to the field can be found in Thrain Eggeston’s Economic Behavior and Institutions (Cambridge University Press, 1990).

Nevertheless, one can view the book as an interesting history of how the ideas of a prominent economist have developed. Even more fascinating is the similarity of the conclusions that are reached by Stiglitz and by others who would be considered more in the neo-institutional, transaction cost school. Despite the separate paths taken by these different economists, they all conclude that information is important, that people have incentives to organize their behavior in ways that minimize transaction costs, and that there are incentive and principal-agent problems inherent in government action. Thus this volume can be worth reading, both for its insights into the problems of socialism, and the evolution of the thought and research of a prominent economist.