

Institutional Analysis in the Socialist Calculation Debate

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ABSTRACT: This paper asserts that economists of the mid twentieth century developed two methods of analyzing institutions. Austrian and Coasean economists developed complementary approaches to institutional analysis. Coase developed a research program of Comparative Institutional Analysis, whereby economists compare alternative institutions *according to their most similar features*. Ludwig von Mises and FA Hayek developed a research program of Contrasting Institutional Analysis, whereby economists contrast alternative institutions *according to their most fundamental differences*. Oscar Lange utilized the comparative approach in the Socialist Calculation debate with Mises and Hayek. Lange's success in promoting comparative economics relegated the contrasting approach to obscurity.

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Coasean and Austrian Institutional Analysis

The history of 20th century Austrian and Coasean economic is complex, but we can summarize a few key points briefly. Coasean economics is seen as unique because it focuses on real institutions, as opposed to institution-free Walrasian economics. Austrians generally accept the Coasean critique of institution-free Nirvana theorizing by Walrasians economists. Austrian economics is seen as distinct because of its emphasis on open-ended processes. Coasean economists have developed an equilibrium orientated approach to institutional analysis, while Austrians examine institutions as part of a competitive process.

The prevailing history of Austrian economics overlooks the uniqueness of the Mises-Hayek approach to analyzing institutions. This paper aims at clarifying the Mises-Hayek approach to analyzing institutions. The first part of this paper argues that while Coase *compared* institutions according to their greatest similarities, Mises and Hayek *contrasted* alternative institutions according to their greatest and most essential differences. The second part of this paper examines how Mises and Hayek developed their approach of contrasting institutions in the socialist calculation debate. Mises and Hayek were seen to have lost the calculation debate largely because of their failure to make their approach to institutional analysis explicit. The final part of this paper asserts that modern economists can better understand institutions by utilizing the Mises-Hayek approach to analyzing institutions.

Institutional Analysis in the 20th Century

New Institutional Economics developed largely in response to the Walrasian practice of condemning markets for failing short of first-best competitive equilibrium. Coase (1960) and Demsetz (1969) insisted upon comparing alternative institutions according to their imperfections. Specifically, Coaseans attempt to find the least imperfect institutions by applying the same models to alternative institutions.

The Coasean approach has obvious advantages, but also serious limitations. The practice of applying the same models to different institutions leads naturally to the view that alternative institutions are relatively similar. In order to apply the same models to alternative institutions, we must make similar assumptions regarding the characteristics of these institutions. Public Choice economists take the Coasean approach when they assume imperfect information and imperfect competition in both the private and public sector. The Coasean approach is therefore biased towards portraying alternative institutions as being very similar. There are, of course, some similarities between alternative institutions. However, we choose between alternatives primarily because of their differences. Similarity tends to indicate indifference rather than distinct preference.

Austrian economics deals primarily with the process of competition” and Walrasian economics deals primarily “with the determination of economic equilibrium (Rosen 1997 p139). Rosen defends neoclassical economics against the charge that it ignores economic processes, but this defense is arguably irrelevant. Austrian economists (i.e. Hayek, Mises, and Schumpeter) expected perfection from neither private nor public institutions¹. Coasean and Austrian economists do seem to agree on some critical issues. There is, however, a difference between holding alternative institutions to the same standards and analyzing institutions with the same models and similar assumption. Mises and Hayek held private and public sector institutions to similar standards, but contrasted these institutions according to their greatest and most fundamental differences.

¹ “We do not assert that the capitalist mode of economic calculation guarantees the absolutely best solution of the allocation of factors of production. Such absolutely perfect solutions of any problem are out of reach of mortal men. What the operation of a market not sabotaged by the interference of compulsion and coercion can bring about is merely the best solution accessible to the human mind” Mises 1949 p701

There are many examples of early Austrians utilizing the method of contrast. Menger (1871) contrasted an exchange economy based on extensive division of labor with autarkic economies. Menger considered the economic problems of choice faced Robinson Crusoe. An isolated individual faces the problems of scarcity and choice. But in an exchange economy we face a problem of coordinating the use of many 'higher order goods' (i.e. capital goods), under the command of many different individuals at different stages of production. Hayek (1937) saw the importance of the contrast that Menger drew between Crusoe and complex economies. Hayek saw that individuals are in some sense always in private equilibrium, given their personal knowledge and perceptions (Caldwell 1988 p526). With extensive division of labor a knowledge problem arises whereby plan coordination requires that each form plans that contain relevant data from the plans of others. Milton Friedman (1962 p13) sees economics as the study of 'a number of independent households, a collection of Robinson Crusoes'. Unlike Hayek, Friedman sees no essential difference between a Crusoe economy and a complex exchange economy. The contrast that Menger and Hayek drew between a Crusoe economy and an exchange economy is central to Austrian economics, and absent from Chicago economics. Mises also illustrated the functions of entrepreneurship "by method of contrast" (Cowen and Fink 1985 p866). In an economy without uncertainty entrepreneurial functions vanish. Entrepreneurs fulfill the role of planning production given that economic conditions continually change. Austrians have contrasted both an institution free Crusoe economy and an imaginary entrepreneur free static economy with capitalism. But where have Austrians contrasted alternative institutions?

The development of the Mises-Hayek program of Contrasting Institutional Analysis reached its height during the interwar debate on socialist calculation. Lavoie (1985) and Boettke (1990) explain the Mises-Hayek critique in the following terms: socialism lacks

genuine markets. The absence of genuine markets renders price formation impossible. Without prices as estimates of true economic costs, rational allocation is impossible. Lavoie and Boettke explain the market socialist response to Mises and Hayek in the following terms: Lange (1938) and Dickinson (1939) thought socialist managers could discover market-clearing prices by merely adjusting official price controls for goods, while monitoring inventories. Rising and falling inventories indicate excess supply and demand in either system. Lavoie and Boettke criticize the Lange and Dickinson for proposing an illegitimate market simulation. Markets cannot be replicated through edicts. Markets require real entrepreneurship to function with relative efficiency (Kirzner 1973, 1985).

Lavoie, Kirzner, and Boettke all agree that the Mises-Hayek critique was about the feasibility of alternative institutions, but the central points of the Mises-Hayek analysis of capitalist and socialist institutions require further examination. Mises objected to socialism because it replaces financial management with bureaucratic management. Mises contrasted these two types of management.

“The great historical conflict between individualism and collectivism is dividing mankind into two hostile camps. Therefore the investigation into the contrast between bureaucratic and business management is still of current importance” Mises 1962 p vi

If bureaucrats are allowed discretion in managing production, they will act irresponsibly even if they share in profits, because of a lack of seriousness or moral hazard (Mises 1922 [1936] p191, 1927 p102). With commercial profit management “there is no need to limit the discretion of subordinates by rules or regulations ... but in public administration there is no connection between revenue and expenditure ... this makes it indispensable to operate public offices according to principles *entirely different* from those applied under the profit motive” Mises 1944 p50-51 emphasis added. There are many other examples of Mises

insisting that private enterprises and public bureaucracies must be viewed as opposite types of organizations². Mises focused on what he saw as the greatest and most fundamental differences between the private and public sector. Mises contrasted the flexible and entrepreneurial nature of the former with the rigid bureaucratic nature of the latter. Bureaucratic management based on regulations and commercial management based on profit and loss accounting are opposite types of organization.

Mises recognized the Nirvana Fallacy in the writings of some socialists, but found the issues related to Nirvana theorizing unimportant.

“it must be said that it is inadmissible to pick out special costs in capitalist society, and then at once to infer from the fact that they would disappear in a socialist society, that the productivity of the latter would surpass that of the former. It is necessary to compare the *total* costs and the *total* yields of both systems.” Mises 1922[1936]

The above passage comments on the comparative operating costs of markets and government in allocating resources. Mises thought of the idea of comparing private and public institutions according to their operating costs in 1922, decades before Coase promoted this idea in his 1937 and 1960 papers. Mises recognized that Coasean comparisons of relative operating costs do not produce definitive conclusions regarding alternative

² Mises (1930 [2002] p163 emphasis added) contrasted commercial management, which “has as its compass nothing except the profitability of business”, with public management which is “in a *completely different* salutation, since success or failure cannot be evaluated by auditing”. Mises (1932 [2002] p373-6) contrasted the “mental tool of monetary calculation” in commerce with “the fundamentally different pattern” of bureaucratic administration. Commerce is regulated by the market test of profit and lose, whose outcomes cannot be known in advance. In contrast, the “essence of bureaucracy is compliance with rules and formalism”. Mises (1944 p51) defined bureaucratic management as “the method applied in the conduct of administrative affairs the result of which has no cash value on the market”.

institutions because the operating costs of alternative institutions vary³. Since operating costs vary from one historical case to another there is no a-priori basis for comparing the total operating costs of capitalism and socialism. A-priori conclusions regarding the total yields of capitalism and socialism derive from the contrast that Mises drew between bureaucratic and financial institutions: “the opposite of this [private] type of enterprise, whose every transaction is controlled by the calculation of profit and loss, is represented by the apparatus of public administration” (Mises 1927 p98). Socialism is inefficient because public administration is unable to deal with the dynamic problem of how to “increase production and achieve economic progress” (Mises 1922[1936]), not because public administration itself consumes too many resources.

Lavoie (1985), Vaughn (1980), and Boettke (1990) claim that Lange and Lerner won over professional opinion because they thought in terms of increasingly popular equilibrium models, while Mises and Hayek thought in dynamic terms that his opponents never understood. The Lavoie-Boettke argument builds upon Hayek’s 1940 remark that the Lange-Dickinson proposal derived from ‘an excessive preoccupation with equilibrium’. Hayek

³ As Mises put it “Socialistic criticism of the capitalist system devotes much space to complaints about the high costs of the apparatus of distribution ... They include the expense to society arising from free competition. All the expenditure on advertisement and the activities of persons involved in the competitive struggle such as agents, commercial travelers, etc., and the costs entailed by the efforts of firms to remain independent instead of amalgamating into larger units or joining cartels which make possible specialization and thereby the cheapening of production, are debited to the distributive process of the capitalist system... The socialistic society will, so the critics think, save enormously by putting an end to this waste... The socialist apparatus of coercion too will entail some expense. *Whether this will be greater or less than the expense of the state apparatus of the capitalist society naturally we cannot say.*” (Mises 1922 [1936] p140-141 emphasis added)

characterized the use of equilibrium by his opponents as excessive, but not worthless. Hayek (1937) explained why final states of rest are completely unrealistic, but also allowed for incomplete equilibria that change through time.

The distinction between comparing and contrasting alternative institutions in the socialist calculation debate provides a better explanation as to why Mises and Hayek were perceived to have lost this debate. While it might be the case that the profession was attracted to Lange's equilibrium analysis, it is more important to realize that Lange framed the debate in comparative terms. Lange argued that socialism could be made to work in the same way as capitalism. Lange made a comparison between his socialist proposal for pricing by bureaucrats through trial and error, and the trial and error process that eliminates excess supply and excess demand in real markets. Lange created a false impression that socialism could function like capitalism by ignoring the essential differences between these two systems, and focusing instead on their alleged similarities. All that was supposedly needed for socialism to work was a few directives from a central agency to maximize profits and minimize costs. Lower level bureaucrats could then carry out functions formerly performed by capitalist managers. The critical point from Mises and Hayek is that socialist bureaucracies cannot be made to function like markets because these two types of institutions are by their very nature opposites: one is entrepreneurial and the other is bureaucratic. Lange was seen to have won because professional opinion overlooked the contrast that Mises and Hayek drew between entrepreneurial capitalism and bureaucratic socialism.

Lavoie and Boettke insist that Lange arrived at the wrong conclusions because he was an equilibrium theorist. The Lavoie-Boettke interpretation of the calculation debate might seem plausible at first glance. Lange did propose equilibrium pricing as a solution to the socialist calculation problem, and Hayek did find problems with Lange's excessive preoccupation

with equilibrium. Perhaps Lange's preoccupation with equilibrium led him to make an irrelevant comparison between pricing of actual stocks of goods in socialism and capitalism. In any case, professional opinion swung towards Lange because it seemed plausible that state officials could adjust prices while monitoring inventories- given the assumption that socialism could be organized in a way that would enable it to function like a market system.

There are additional details to the contrast that Mises drew between capitalism and socialism Mises contrasted planning of capital investment in financial markets with socialist planning by officials. The Lange-Dickinson competitive solution aimed at simulating spot markets for goods that physically exist. Mises was not concerned with whether or not socialist officials could simulate spot markets accurately.

“Nobody has ever suggested that the socialist commonwealth could invite the promoters and speculators to continue their speculations and then deliver their profits to the common chest. Those suggesting a quasi-market for the socialist system have never wanted to preserve the stock and commodity exchanges, the trading in futures, and the bankers and moneylenders as quasi-institutions. One cannot *play* speculation and investment. The speculators and investors expose their own wealth, their own destiny. This fact makes them responsible to the consumers, the ultimate bosses of the capitalist economy. If one relieves them of this responsibility, one deprives them of their very character” Mises 1949 p705

Mises was actually concerned with the total absence of financial markets in all forms of socialism, including market socialism. Socialism fails because of the fundamental difference between capitalism, where financial markets determine the pattern and rate of investment, and socialism, where either bureaucrats or high officials determine the pattern and rate of investment arbitrarily or politically: this is the essential difference.

Lange, Dickinson, and Lerner admitted that elimination of financial markets in socialism renders capital investment arbitrary or political. For example, Lange (1938 p84-86) and

Dickinson (1939 p207) admitted that socialist officials would harm consumer welfare by setting capital accumulation rates 'arbitrarily'. While the admission that centrally planned investment must be arbitrary or political is a serious concession, Lange and Dickinson also argued that financial markets are just as arbitrary as central planning. Lange (1938 p108-109) and Dickinson (1939 p208) attempted to offset their admission by arguing that capitalist capital accumulation is also arbitrary because capitalist inequality derives from 'historical data that are independent of welfare maximization'. The Lange-Dickinson argument regarding private investment is simple: investment is determined by saving, saving derives mainly from income of the wealthy, and income inequality is an arbitrary artifact of history. Capital investment gets determined by either a political elite in socialism or an economic elite in capitalism, and both do it arbitrarily. Lange and Dickinson sought to *compare* state planned investment with financially planned investment by arguing that both political and economic power tends to be concentrated and arbitrary in nature. Lange compared interest rate determination in these two systems according to alleged similar features. The preceding paragraph pointed to a fundamental difference that Mises and Hayek saw between the determination of political and economic elites. Lange and Dickinson chose to compare private and political entrepreneurs according to similarities concerning the concentration of power; Mises and Hayek contrasted entrepreneurs and officials according to differences in how one acquires and retains 'power'. Mises and Hayek contrasted financial markets and central planning; Lange and Dickinson compared these institutions. Schumpeter also compared state planning with planning in financial markets. Since much of private investment comes from retained corporate profits, a socialist society could "achieve a similar or even greater rate of real investment" out of "profits" accumulated out of state enterprises (Schumpeter 1942 p179-180).

Boettke overlooks the importance of financial markets in the Mises-Hayek critique.

“At the time of L. v. Mises’s first writing, the meaning of socialism and central planning were unquestioningly identified with the elimination of the market as a means of allocating resources and its replacement by a system of direct allocations. The market socialist response to Mises, however, did not advocate the elimination of the market. Boettke 1990 p27

The earlier quote from Mises (among others) indicates that he saw stock and other financial markets as ‘the market’ that perform economic calculation⁴. Since market socialism lacks any simulation of financial markets, the market socialist response to Mises *did* advocate the elimination of ‘the market’. Boettke challenges the legitimacy of market socialism by arguing that simulated spot markets compare poorly to actual spot markets, but this is irrelevant. Mises actually contrasted state planned investment with financially planned investment. The ability of state officials to simulate spot markets was irrelevant because the real failing of socialism is in the investment decisions that determine inventories in spot markets.

Since Mises actually contrasted financial markets with state planning of investment, the debate over how well real and simulated markets compare is irrelevant. Elimination of financial markets eliminates profit-driven entrepreneurial activity that moves us from inferior plain states of rest to superior plain states of rest. Socialism results in bureaucratic rigidity and arbitrary or political central planning of aggregate investment.

Lavoie (1985 p28) is on the right track when he notes that Mises initially directed his challenge against Marxists. It should be noted that Marxists like Hilferding, and also Historicists, focused much attention on the rise of financial capitalism in the late twentieth century. Mises focused on the contrast between the global order of financial capitalism and the bureaucratic order of state planning because this was *the* issue at hand. Mises

⁴ See also Mises 1922[1936] p182-3, 1922[1936] p121, 1949 p514-515, and 1949 p701

(1919[1983]) critiqued the idea that experience with ‘war socialism’ had demonstrated that socialism could work in peacetime. Lavoie (1985 p22) supports the main arguments of this paper when he writes notes that ‘the usual conclusion that [static] economic theory cannot decide important issues comparative economics is invalid [but] Austrian theory provides informative theoretical contrasts between ... free market capitalism and socialism’. Lavoie (1985 p30) also claimed that Marx developed an implicit conception of socialism as the theoretical photonegative of capitalism. *Das Kapital* described the “fundamental attributes of socialism”. Marx’s negative critique of capitalism implied a positive theory of socialism: “Marx condemns the market order only by *contrasting* this system with an ideal system where individuals ... subordinate their social relations to their own communal control” (ibid p37 emphasis added). Lavoie’s reading of Marx fits with the idea that the calculation debate was about contrasting capitalism and socialism according to their essential differences. While Lavoie explicitly criticized Lange for his use of equilibrium concepts, there is evidence indicating that he would have agreed that Lange compared capitalism while Mises contrasted these systems. Lavoie utilized the method of contrast, and may well have agreed that Lange and Lerner failed to address Mises not because they thought in terms of equilibrium, but rather because they thought in comparative terms which made it impossible for them to understand the Mises-Hayek critique.

Lavoie characterizes the debate over market socialism as a diversion into statics that ignored rivalry. Lavoie and Boettke both insist that Lange and Lerner never understood the challenge that Mises posed. Lange and Lerner supposedly won over professional opinion by defining the debate in terms of equilibrium. The idea that Mises and Hayek failed to win over professional opinion due to the rise of equilibrium analysis actually has little support in the literature. Hayek made his objection to ‘excessive preoccupation with equilibrium’

explicit. Were Lange and Hayek's student Lerner too stupid to understand Hayek at least partially? In a letter to Hayek, Lange (1940) credited Hayek (1940) for introducing the dynamics of anticipation into the calculation debate. While Lange erred by failing to see that the Mises (1920) introduced dynamics into this debate at its inception, he did recognize dynamic issues in Hayek's work before the debate ended. Lerner (1937) actually accused Hayek of failing to understand the importance of future prices in determining true economic costs⁵. Which point was the profession more likely to overlook: the explicit point that Mises and Hayek made about the importance of dynamics, or their implicit point about the essential contrast between capitalism and socialism?

Lavoie (1985 p 21) contends that Lange based his proposal for market socialism on a close analogy with perfect competition. We should interpret Lange's close analogy as an attempt to compare capitalism and socialism. That is, Lange focused on elements of capitalism and socialism are similar, or might at least be made similar. Lange thought that capitalism worked because of a trial and error process whereby excess demand and excess supply are eliminated. Lange (1938) and Lerner (1938) thought that socialism could be made to work in a similar fashion through the imposition of rules. Socialist bureaucrats could be made to with equate prices with marginal costs and to act as if they are maximizing real profits. Critics of Lange and his allies have accused him of theorizing in an institutional vacuum. The institution-free model of perfect competition simply does not explain how real markets work. The above criticism of Lange is unfounded. Lange's view of the market and

⁵ "It is not strictly accurate to say, as Dr. Hayek does, that the cost of using the instrument depends upon the price of the product itself, and thereby to suggest that the derivation of a supply price from the cost would involve circular reasoning. The cost depends not on the present price, but on the *expected future price*; and this must be true whatever the form of the economy." Lerner 1937 p269

of central planning boards may be naïve or poorly supported, but Lange *was* writing about institutions when he proposed that central planning boards could simulate competitive markets. Furthermore, we must remember that Lange was building upon Taylor's 1929 article. Market socialism was a relatively new set of ideas at the time Lange wrote his book. Since then scholars like Roemer (1994) have expanded upon Lange's work, much in the same way that Kirzner and Lavoie expanded upon Hayek's work. Lange's proposal was an early effort at comparing the institutions of the market and central planning boards. Lange was an institutional economist. The problem with Lange's analysis was not with a lack of institutional analysis, but with his approach to institutional analysis. A fully developed version of Lange's comparative analysis would also fail to take account of the contrast that Mises drew between capitalism and socialism.

Lavoie (1985 p 16) notes that in the standard account (i.e. Bergson 1948) of the calculation debate, economic theory cannot settle the issue of which system works best. Neither capitalism nor socialism is as praiseworthy as their proponents claim, and both systems face practical problems. Bergson's conclusions stem from Lange's comparative approach. Since Lange tried to compare capitalism and socialism according to their alleged similarities, it was only natural for Bergson to conclude that theory cannot settle the issue at hand. If all theory can tell us is that socialism will work in virtually the same way as capitalism, then it is obvious that theory cannot tell us which system works better.

Kirzner, like Mises, points to fundamental differences between capitalism and socialism with his focus on entrepreneurship. Kirzner claims that the Lange-Lerner proposal ignores the role that entrepreneurs play in adjusting prices. It is simply naïve to think that the problems of pricing capital goods can be solved by imposing rules on socialist bureaucrats. In other words, there is no analogy to draw between the market process and the workings of

an actual socialist economy. The failure of socialism is in its fundamental differences with capitalism. We learn which system works best by contrasting their differences, not by comparing their alleged similarities.

Mises' distinction between entrepreneurial and managerial functions is well known, but not fully explained. Entrepreneurs direct production by forming plans, which must meet the approval of capitalists in financial markets. Managers carry out plans afterwards by buying labor and capital in higher order spot markets, to produce consumer goods for sale in lower order spot markets. While some contemporary scholars disagree with the idea that financial markets direct capital investment in an efficient manner, textual evidence indicates that financial markets played a primary role in the von Mises critique of socialism. Lavoie and Boettke overlooked the contrast that Mises saw between financial markets and bureaucracy. It is the markets that socialists refuse and cannot simulate that matter most- financial markets. Lavoie and Boettke merely assert that capitalist markets and socialist "markets" compare poorly because the latter are simulated.

Both Lavoie and Kirzner implicitly view the calculation debate in contrasting terms, rather than comparative terms. The idea of contrasting alternative institutions has been overlooked, but it is deeply ingrained in the Austrian paradigm, so much so that it drives Austrian political economy. Mises and Hayek also contrasted private and public leadership. Mises (1949 p701) dismissed the trial and error solution penned by Lange because the test of profit and loss "is the only important respect in which markets are a system of trial and error". In a competitive environment, profits reward highly adept entrepreneurs for best anticipating future consumer demands. Losses remove inept entrepreneurs from positions of authority in industry. In capitalism the best get on top. Hayek (1944) argues that in contrast to private competition, political competition results in the worst rising to the top. There is a

distinct tendency for people who desire power and are effective at using it to be the worst among us. Naturally a socialist would try to turn this reasoning around by arguing that the worst rise to the top in capitalism, where economic power can be abused. But Hayek contrast economic power in the hands of capitalists, which is limited by competition, with the economic power of socialist officials, which is “infinitely heightened by concentrating power so that it can be used in the service of a single plan”. Furthermore, the people who succeed in markets are radically different from those who succeed in politics because politics offers different types of opportunities which appeal to different minded people.

Mises and Hayek used the method of contrast in both the calculation and serfdom critiques of socialism. The method of contrast is also central to the Austrian understanding of entrepreneurship and the knowledge problem. One might also interpret the Austrian literature on business cycles as analysis that contrasts central banking with free banking, but this particular claim is beyond the scope of this paper. Our attention should remain fixed on the calculation debate and Coasean economics.

Lange was seen to have won the socialist calculation debate because he succeeded in getting his peers to think in comparative terms. Mises and Hayek failed to get their peers to think about the fundamental differences between capitalism and socialism clear. Postwar Walrasians were vulnerable to Coasean criticism because they held markets to the unreasonable standard of competitive equilibrium. Coase and Demsetz took the easy path of critiquing Walrasians for their Nirvana analysis, *in terms of comparative analysis*. Modern Austrians chose the hard path of arguing against equilibrium analysis, and by advancing subtle points about tacit knowledge and the market process.

The idea that capitalism and socialism have fundamental differences that need to be contrasted is rather simple. Modern Austrians were oblivious to a simple and compelling

argument, implicit yet central to the Mises-Hayek paradigm. Mises and Hayek failed to sway professional opinion not because the points that they made explicit (i.e. the importance of dynamics and excessive preoccupation with equilibrium) were misunderstood or ignored. Mises and Hayek failed to sway professional opinion in the calculation debate because the point they left implicit (contrasting institutions) needed to be explicit if they were to counter Lange and Lerner. Lavoie is correct in his contention that Lange never understood the challenge he faced, but mistaken about the specific source of misunderstanding. Lange and his allies thought in comparative terms only, so they failed to appreciate the contrast that Mises-Hayek drew between capitalism and socialism in their critique.

Institutional Analysis in the 20th and 21st Centuries

The arguments of this paper clarify the deficiencies of Walrasian analysis. Walrasian analysis is unrealistic because of it ignores the importance of institutions. The Coasean comparative approach has yielded important insights regarding institutions. The Austrian approach of contrasting institutions yields further insights concerning institutions. When combined, comparative and contrasting analysis of institutions produces a more complete theory of social phenomena. While the Coasean program alone offers advantages over Walrasian economics, a combined Austrian-Coasean research program that compares and contrasts institutions has even greater advantages over Walrasian economics.

Mises and Hayek agreed with the Coasean critique of Walrasian false comparisons between imperfect markets and government run by benevolent and omniscient social planners, but took a different approach to analyzing alternative institutions. Since the Coasean program applies the same models to alternative institutions, it naturally focuses on the most similar features of alternative institutions. Coasean analysis therefore tends to portray private and public sector institutions as close substitutes. Modern Austrians have

tended to embrace the comparative institutions approach of Coaseans, while stressing the importance of process theorizing. The actual Austrian program developed by Mises and Hayek focuses on contrasting alternative institutions according to their most fundamental differences. The approach of contrasting institutions tends to promote the view that private and public sector institutions are anything but close substitutes. Mises and Hayek contrasted finance capitalism with bureaucratic socialism.

Emphasis on comparing institutions misled professional in the mid twentieth century. Lange, Lerner, and Dickinson convinced the economics profession that socialism could match or exceed the performance of capitalism by comparing both systems according to alleged similarities. Mises and Hayek failed to sway professional opinion because they failed to frame the Calculation debate in contrasting terms. Mises and Hayek could not possibly demonstrate the fundamental differences between and socialism within a comparative framework which focuses on relative similarities.

Coaseans achieved some success against the Walrasian mainstream by making their approach of comparing institutions explicit. The Coasean program seems less revolutionary when one considers that Lange and his allies took a similar approach. While the role of institutions in the Lange-Dickinson proposal might seem weak as compared to the work of Coase, North, or Williamson, Lange and his allies did compare central planning boards and markets *as institutions*. Comparative analysis is indispensable, but contrasting analysis adds much to our understanding of institutions. Twentieth century economists erred when they chose the comparative approach over contrasting institutional analysis. Comparative and contrasting institutional analyses complement each other. Twenty-first century economists should consider a combined Comparative-Contrasting approach to institutional analysis, as this approach offers a fuller understanding of economic systems.

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