

**SOCIALISM AND THE MARKET:**  
**CONCEPTUAL CLARIFICATION**

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## **Introduction**<sup>1</sup>

The linking of two terms, socialism and market has a long history. Various combinations and linkages have emerged in the long-lasting, sometimes rather heated debates, both in academic circles, and in the political sphere as well. E.g. "market socialism" or "socialist market economy, to mention only two widely used examples.

The main purpose of our Roundtable is to look at recent Chinese and Vietnamese experience. The study of the real history of these two countries might help in the reconsideration of the relationship between socialism and market. Also an approach the other way around could be quite useful. Recalling the political and academic debates of the past can contribute to a better understanding of the realities in contemporary history. Analysts are at risk of getting lost in minor details. Confronting today's experience with the century-old intense debates puts the Chinese and Vietnamese development in a wider historical context

These debates have always been blurred by conceptual confusion so far. The purpose of the introductory lecture is to attempt some conceptual clarification.

## **Interpretation of the term "market"**

The interpretation of the concept of *market* is not too difficult. Here we have—more or less—a consensus. In the present context I underline a few properties to characterize the market.

Market is a mechanism for coordinating human activities. It is a social arrangement for the integration of society.<sup>2</sup>

Market is not the only mechanism of coordination and integration. I mention only one alternative, a feasible and powerful one, bureaucratic coordination, for example, which is especially relevant in the context of Chinese and Vietnamese experience. That served as the main coordinator for decades in these two countries. There are many

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<sup>1</sup> The author gratefully acknowledges the assistance of Katalin Szabó and Ágnes Schöner.

<sup>2</sup> Most textbooks and dictionaries of economics offer a concise characterization of the concept of "market", and also various classifications of markets. See e.g. Mankiw, 2001, or Nordhaus 2002. I am using here, and in later parts of the paper the conceptual framework of my book *The Socialist System* (1992.)

important differences between bureaucratic and market coordination in the degree of centralization or decentralization, in the nature of information flows, and in the incentives associated with the type of coordination. Market and bureaucratic coordination, these are only two, albeit especially relevant examples; history has generated other coordination mechanisms as well. As time goes on, societies choose -- deliberately or by spontaneous processes -- between alternative coordination mechanisms. Reform in China and Vietnam includes, among other changes, a shift away from the predominance of bureaucratic coordination towards predominance of market coordination.

### **Interpretation of the term "socialism"**

While there is a wide consensus concerning the meaning of the term "market", there are great difficulties with the concept of "socialism". Several interpretations exist. What we witness here is not simply hairsplitting linguistic disagreement. On the surface it looks like a controversy about the interpretation of a single word. In fact, the conceptual debate is heavily loaded with political values, with the struggle for the realization of alternative visions of a "good society", and with sharp divisions concerning the strategy leading to the creation of a new order. It is not about words, but about political rhetoric and ideologies. I fully understand that some of our colleagues must take into account tactical considerations, they cannot be completely outspoken, and find it more productive to go around clear-cut definitions. My personal situation is easier. Permit me the liberty to put aside all "diplomatic" aspects and face the genuine problems.

I will discuss five interpretations of the term "socialism". There are many more, but most of them can be treated as blends or combinations of my five pure interpretations, or as intermediate, temporal, or transitional stages between the pure cases.

#### ***Interpretation #1: Marx's concept of "socialism"***

Let us start with Karl Marx. He was not the first to use the term "socialism". The official training in Marxism as it was practiced in the countries under the rule of the communist party, liked to use the somewhat pejorative label "utopian socialists", for towering figures

of intellectual and political history like Saint-Simon, Owen and Fourier, and contrast their ideas with "scientific socialism". The latter allegedly begins with Marx.

Certainly Marx opens a new chapter in the history of socialist ideas, and his teachings had and still have tremendous influence on political thought and action. It seems to be proper to focus on his contribution.

Marx was not eager to give a detailed description of a future socialist system. He even made sarcastic comments on German professors, who drew up a blueprint of a desired socialist order in minute details. He restricted himself to drop a few hints here and there. His thoughts on socialism can partly be constructed from a negative approach: what are the features of capitalism he would furiously reject.

Political structure. Marx had no clear design for the political regime of socialism. There are fragments in his works which allow to build up the organization of his thoughts on the subject.

Marx certainly did not appreciate "bourgeois democracy". He was ready to ridicule the emptiness of liberal political ideas.

There are often quoted lines where he advocated the dictatorship of the proletariat needed on the way to the full-fledged communist system.

Also, he had some really naïve anarchistic ideas about the political situation at the stage of "communism". Since every need will be met, the necessity of any kind of force or repression will automatically cease. The state will spontaneously shrink and will finally disappear, and only the rational self-governance of the community will remain.

Marx certainly did not advocate a brutal, repressive, totalitarian Leninist-Stalinist-Maoist state. Nevertheless, dictatorship was not incompatible with Marx at least for an indefinite period of transition to communism.<sup>3</sup>

Ownership. Under the capitalist system productive assets are owned and managed by the capitalists. The capitalist class is exploiting the proletariat, not because they are

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<sup>3</sup> Marx and Engels wrote already in the *Communist Manifesto* that the proletariat after the victorious revolution will assume "political supremacy." Later on Engels formulated the Marxist position this way: "...the necessity of the political action of the proletariat and of the dictatorship of the proletariat as the transitional stage to the abolition of classes and with them of the state..." (Engels, [1872] 1976, 370) Lenin quoted the words of Marx and Engels with great emphasis in his famous book *State and Revolution*, [1917] 1969, which laid the groundwork for the construction of the Leninist theory on the state and dictatorship. He wanted to demonstrate the theoretical continuity between the ideas of Marx and Engels and his own thoughts on the issues of creating dictatorship and rejecting parliamentary democracy.

merciless cruel people, but because they are the legal owners of capital. The world has to be changed, it is time to expropriate the expropriators. It emerges from this train of thought that Marx and Engels opted for public ownership. "...The proletariat will use its political supremacy to wrest, by degrees, all capital from the bourgeoisie, to centralize all instruments of production in the hands of the State, i.e. of the proletariat organized as the ruling class... .." (Marx and Engels, *Communist Manifesto*, [1847] 1976, 504). He did not specify, however, the route leading to the complete centralization of all means of production in the State's hands, and the institutional framework of public ownership.

In any case, Marx had a strong position on the ownership issue. In the *Communist Manifesto* he highly appreciated the progressive role of early capitalism in cleaning up society from the remnants of feudalism. But that time was over, and capitalists became a hindrance to progress. He did not make fine distinctions between small and big capitalists, he just wanted to get rid of capitalism for the sake of a more productive new system.

Coordination mechanism. The three huge volumes of *Das Capital* are devoted to the study of the market economy. Capitalism is coordinated by the market. Marx's scholarly interest is focused on the understanding of how the market works. His summary verdict is in stark contrast to his admired predecessor in classical economics, Adam Smith. Smith had great respect to the incredible achievement of the invisible hand. Millions of uncoordinated, decentralized decision-makers finally come up with a balanced state of the economy. Marx was not impressed. On the contrary he regarded the market as a spectacular manifestation of anarchy. He did not study the problem of efficiency carefully, but almost by instinct came up with the conclusion that the operation of the market leads to waste. His thoughts on socialism can be reconstructed mainly by the negative approach again. It must be exactly the opposite of the coordination mechanism at work under capitalism. If that is irrational -- coordination under socialism will be rational. It will be a conscious and reasonable allocation of production forces or of labor or of time spent on labor. Marx, as usual, did not offer a blueprint for central planning, but his idea of reasonable allocation is compatible with central planning and incompatible with the market.

Market—as the chief coordinator of a future socialist system —is a sharply anti-Marxist idea. It is completely alien not only from the words of Marx, but --what is perhaps even more important -- from the spirit of Marx's contrast between capitalism and socialism.

Ideology. Marx was among the first social scientists who recognized the important role of ideology. At the same time, he did not claim to be a prophet himself. He probably would have been embarrassed to see what various political groups are doing hundred years later under the banner of Marxism. He tried to understand the ideologies of capitalism, but did not suggest a new ideology for socialism.

### ***Interpretation #2: the Walrasian concept of "socialism"***

This interpretation emerged in the quiet life of academia. The pioneer of so-called “theory of socialism” was the Italian economist Enrico Barone, a disciple of Pareto (Barone [1908] 1935.) Although even early works generated some response in the economic profession, the real break-through came with the seminal paper of Oscar Lange, the Polish economist on the theory of socialism (Lange [1938] 1956.) There were quite a few other economists who subsequently elaborated Lange's ideas in more details, first of all Abba Lerner, in his influential book *Economics of Control*, 1946.. For the sake of concise treatment, I will focus exclusively on the Lange-theory.

Oscar Lange's model of socialism fits tightly into the theoretical framework of Walrasian economics. In fact, it is a special application of General Equilibrium theory, pioneered by Leon Walras, and reaching its later climax in the work of Arrow, Debreu and other contemporary theorists. No need to outline the whole train of thought, since our exclusive theme is the interpretation of the term "socialism".

In the world of the Lange-model the notion “socialism” means public ownership -- and nothing else. That is the necessary and sufficient condition of calling a system "socialist". Read the Lange-paper carefully again. You do not find a single word about power, about the structure of the political regime, about ideology. Ownership matters only.

Oscar Lange does not clarify the exact place of public ownership in the total composition of ownership-structure. Is the publicly owned sector only a part of the whole

economy? Is it the dominant part, or are all the assets owned by the public? I present here my own interpretation. The Lange paper contains the following alternative tacit assumptions: all productive assets of the economy or the dominant part of them are in public ownership. Or it might be assumed that the publicly owned sector can be perfectly isolated from the rest of the economy.

And now here is the final reduction: O.Lange's "market socialism" is a vision of an economy based on public ownership and coordinated by the market. "Socialism" and market -- these two institutional-structural arrangements are compatible.

The Lange-model stirred up a great storm. It received vehement attacks in two great waves. The first rejection came in the brilliant essay of Friedrich von Hayek, 1935. . It was based on the argument that the giant quantity of information and knowledge cannot be collected, stored and utilized in a centralized way. It is indispensable to have decentralized incentives for gathering and making use of knowledge. That is assured by the market and private property, which automatically combines incentives and information.

The second wave emerged in the context of reforming the Soviet and Eastern European socialist economies. The Hayekian incentive and information argument was corroborated by empirical evidence. My own work, inspired by the reform experience, contributed additional arguments for refuting the Lange-theory. It seems to be highly improbable to generate the strong cost-minimizing or profit-maximizing incentive, taken as granted in the world of Lange's theory, in a public firm under a soft budget constraint regime.

It is impossible to couple an arbitrarily chosen ownership structure and an also arbitrarily chosen set of coordination mechanisms. There is close affinity between certain ownership forms and certain coordination mechanisms. Decentralized market and private ownership belong together.

A further important counter-argument comes from the political and ideological sphere. The smooth functioning of the market depends on the "climate". It requires a market-friendly environment. If the politicians ruling a country are sworn enemies of

genuine decentralization, the market will be banned to the black and grey area of the economy and cannot become the fundamental coordinator and integrator.)<sup>4</sup>

Following the collapse of the communist rule the ideas of some kind of market socialism appeared here and there, beside other naïve ideas of a "third way". These proposals were, however, energetically rejected.

Let us now move away from the academic debate, and have a look at political history. A traumatic chasm split the socialist movement around the First World War. Two political movements, two programs, two ideologies separated from each other. And not only separated, but started to fight against each other, at some places in some periods with sad or even tragic consequences.

### ***Interpretation #3: the Leninist concept of "socialism"***

Around WW1, under the leadership of Lenin, communist parties emerged. I do not intend to follow here the history of communist parties, starting before taking power, and ending when they lost power in the Soviet Union and Eastern Europe. I focus only on the time when the power of the communist party had already been consolidated but the erosion of their rule did not started yet. That is what I call "classical socialism". The best example is Stalin's rule for several decades after eliminating his enemies and completing the "expropriation of the expropriators", i.e. finishing nationalization and collectivization -- but before "destabilization" started after the death of the tyrant. We could, of course, find historical realizations of the same type of system in other countries as well. Here is the summary characterization of that system.

Political structure. Democracy despised and rejected in the rhetoric of the Leninist-Stalinist parties. They proudly announce that they exercise the dictatorship of the proletariat. The truth is that we witness here the unshared power of the communist party. That is a regime where the party has complete political monopoly. All competitors are not only excluded, but brutally prosecuted and oppressed.

Ownership. Public ownership of practically all the productive assets is a fundamental feature of the system. Confiscation of private property, nationalization and

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<sup>4</sup> For a wide overview of the contemporary debate on "market socialism" see Bardhan and Roemer, eds. 1993. My own critical remarks are summarized in Kornai 1993.

collectivization is a core element of the political program before taking power, and remains a core element after taking power. The program is implemented consistently and with cruel force. Some pockets of private property remain, but their size is almost irrelevant related to the dominance of public property.

The Leninist position towards private property is confrontative. Even the minor remnants are looked upon with animosity and suspicion. "Small commodity production engenders capitalism and the bourgeoisie continuously, daily, hourly, spontaneously, and on a mass scale" (Lenin [1920] 1966, p.24.)

Coordination. The overwhelming role of the market is replaced by the predominance of central management. The usual name given to this form of coordination is "central planning". A more adequate characterization is bureaucratic coordination, central control, a system of enforcing instructions. This is a "command economy".

Market coordination cannot be expunged completely. It plays a certain role, partly legally tolerated, partly illegally in the various forms of the "black" or "grey" economy.

Ideology: Marxism (later Marxism-Leninism, or still later Marxism-Leninism-Stalinism or -Maoism.) is treated as sacrosanct. Although it cannot keep a perfect monopolistic position in the mind of all people, it retains a monopolistic position in education, in all legal publications, in the media etc. The official ideology rejects all thoughts that are friendly to capitalism, to private ownership, and to the market.

According to the official ideology of that regime the exclusive legitimate user of the term "socialism" is its own system. The Marxist-Leninist-Stalinist-Maoist position on socialism is definitely incompatible with any significant role of the market

#### ***Interpretation #4: the social democratic concept of "socialism"***

Here we discuss the first hundred or more years of social democracy, up to the 1980s and leave out of the scope of conceptual clarification the later changes in social democratic thought. The model countries to keep in mind are Sweden, other Scandinavian countries, and at a later historical stage West Germany and other countries in Western Europe. The movement of social democracy adheres to a set of principles. They accept and implement these principles when they assume power, but respect them also before winning or after losing an election.

Political structure. Being a social democrat means unconditional acceptance of the idea of parliamentary democracy. Exactly here is the deep dividing line between the two great currents of the 20th century. Communists want "socialism" by all means. If you are able to get to power by election, fine. But if not, take power by revolution, by violence, by imposing the will of the party on the people. Social democrats want their own kind of "socialism" if, and only if the majority of people is ready to support their program by voting for their party.

A communist party, once in power, does not abandon its power, even if it becomes clear that it does not have the support of the majority. It is not ready to test the support by competitive election. In contrast, a social democratic party is ready to give up its power if the election results demonstrate the loss of majority support.

The chasm between Leninists and social democrats started with heated debates about tyranny and political competition, the role of parliament and election.<sup>5</sup> Up to the present day, that remains the crucial, decisive criterion to be applied when we want to distinguish Interpretation #3 and #4.

Ownership. Social democracy does not reject off-hand private ownership. Old-style social democrats always rejected crude ways of confiscation. Nevertheless, in some countries (e.g. in Great Britain) they were inclined to assign a significant role to nationalization. As world-wide experience (including the disappointing performance of the Soviet Union and the East European countries) casts the shadow of doubts in the efficiency of nationalized industries, the social democrats gradually gave up nationalization plans and accepted the predominance of private ownership. Still they are ready to maintain a larger segment of the education and medical care sector in public ownership (typically of the local government).

Coordination. Social democrats unhesitatingly rely on the market as the chief coordinator of economic activities. But they are not for unfettered free competition. On the contrary they would insist on using the power of the state for income redistribution. The great accomplishment of their political influence is the creation of the modern welfare state with all the well-known attributes: progressive taxation, free or heavily subsidized education and health service, an extended system of state pension,

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unemployment insurance, financial support for the very poor and so on. Whatever the fiscal problems caused by the expansion of the welfare state are nowadays, social democrats try to preserve what they feel is the main achievement of their political struggle in parliament as an opposition party or, following electoral victories, in the government.

Summing up the remarks on ownership and coordination, we arrive at the following conclusion. Social democrats do not want to create a new "socialist system", fundamentally different from capitalism. What they want is a profound reform of the existing capitalist system. In other words, they would like to see a variation of the capitalist system, closer to their own political and ethical ideals. That includes:

--- Extensive redistribution for the sake of more equity, fairness and justice.

--- Establishment, maintenance and development of the institutions of the modern welfare state. (National health service, free education, pension for all citizens etc.)

Modern social democracy is searching for new ways to overcome the deep fiscal troubles partly associated with the commitments of the welfare state toward the citizenry. The problems are getting more severe under the pressures of demographic changes, the new conditions on the labor market created by new information and communication technology, and the competitive forces of globalization.<sup>6</sup> Nevertheless, certain elements of the traditional social-democratic approach to redistribution and welfare commitments are still maintained.

Ideology. The set of ideas, values, objectives of social democrats is closely linked to the "welfare state" and the democratic political process. It was a hundred years ago when the debate between Lenin, the founding father of the communist stream of the socialist movement, and Kautsky, a highly respected theoretician and party leader in Germany, one of the founding fathers of what became later the social democratic stream evolved.<sup>7</sup> At that time both sides of the controversy referred to Marx as the common theoretical source and highest authority. As time passed, social democrats took more and

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<sup>6</sup> Exploring the feasibility of a "Third Way" is certainly a part of the attempts to modernize the traditional objectives of the social democrats and adjust them to the contemporary world-wide economic conditions. (See Giddens, 2000).

<sup>7</sup> The climax of the debate was the confrontation between the German socialist leader Karl Kautsky advocating the social democrats' position and the bitter attack by Lenin in his famous pamphlets "State and Revolution" [1917] 1969, and "The Proletarian Revolution and the Renegade Kautsky" [1918] 1965.

more distance from Marx and after WW2 completely cut off all ideological linkages to Marxism. The 1959 program accepted at the party meeting of German social democrats in Bad Godesberg opened a new chapter in the history of the movement. European Social Democracy publicly abandoned Marxism, and skipped nationalization as the essential component of the program. Sooner or later all social democratic parties followed the German example (Hodge 1993, Przeworski 1985.)<sup>8</sup>

And now we turn to the theme of our Roundtable.

*Interpretation #5: contemporary Chinese and Vietnamese interpretation of "socialism"?*

There is a question mark at the end of the title, because I only raise the question and do not even try to give an answer. If there is an answer, it is not sure whether it is identical in China and Vietnam. But let us put aside the study of the difference in the understanding of the notion "socialism" in these two countries. Even if there is a difference in the answer, it is still legitimate to ask the same question with respect to both countries.

While I do not undertake to reply, I can offer a few negative remarks. The previous part of the paper outlined four interpretations of the term "socialism". What is going on in China and in Vietnam, the present state of affairs and the changes in the foreseeable future do not fit into any of them.

As for Interpretation #1, Marx was an outspoken enemy of private property and expressed deep distrust in the market. China and Vietnam have already allowed the private sector to grow fast and produce the larger part of GDP. Its share is increasing day by day, and the share of the public sector is shrinking. The predominant part of coordination is left to the market mechanism. Neither China nor Vietnam is a socialist system anymore, if we apply Marx's interpretation of socialism.

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<sup>8</sup> There is a certain kinship between the traditional social democratic interpretation of socialism and the ideas of "Christian Socialism", and the related concept of a "Social Market Economy", a term conceived in postwar West Germany. At the same time, there is a strong demarcation-line concerning the accompanying ideology. (Christianity versus a strictly secular approach to political and ethical issues.) The discussion of this important political and intellectual current is beyond the limits of the present paper.

As for Interpretation #2, China and Vietnam are not the historical realizations of Oscar Lange's theoretical construct called "market socialism". In Lange's abstract world productive assets are in public ownership. Lange made great intellectual effort to prove that the market is able to fulfill its coordination role *without* the existence of private ownership. True, in the real world of China and Vietnam market has become the chief coordinator. That might be a welcome change -- but because of the profound changes in the ownership structure the present state of affairs has nothing to do with the vision of the intellectual school of "market socialism".

As for Interpretation #3, China and Vietnam have preserved an extremely important attribute of the Leninist kind of "socialism". The political structure has remained basically unchanged. The communist party has maintained its political monopoly. The party-state has unrestricted totalitarian power. There is no legally admitted political competition between parties and ideologies, any opposition, dissident or truly independent movement is repressed.

On the other hand, the ownership-structure has gone through fundamental changes, giving up the leading role of the state-owned sector. The role of bureaucratic coordination and central management has been drastically reduced, and been replaced to a large extent by market. It is far, very far from a classical socialist system, and rather close to a typical capitalist system. Also the official ideology has gone through drastic changes. The communist party, which traditionally opposed to private property and market, has become friendly to these arrangements. From a vehemently anti-capitalist view of the world it has shifted toward pro-capitalist values and principles. Today's communist parties in these two countries are parties friendly to capitalism disguised by Marxist-Leninist slogans, and by faithful references to the thoughts of Mao and Ho Shi Minh.

As for Interpretation #4, the two main attributes of true social democracy is missing. First of all, dictatorship, single-party rule is preserved, and the idea of a competitive election is angrily rejected.

Furthermore, the old-style communist regime made serious efforts to build up at least certain elements of a welfare state in the sectors of education, health care and pension, for all citizens or -- concerning some services -- at least for the employees of

public enterprises. Doing so, the former governments were, of course, limited by the low level of production and development. The efforts could not lead to a well-funded modern welfare state. The efforts in some instances even went beyond the limits of affordability and produced a premature welfare state. Now this situation is over. The state has started to withdraw from welfare services for the sake of a better fiscal balance and more efficient competitiveness of the private sector. The extent of redistribution is diminishing, inequality is dramatically increasing, distance between the rich and the poor is growing. China and Vietnam is not moving (in relative terms, in the pattern of income distribution and social services) in the direction of the social-democratic Scandinavian model, but rather in the direction of an early 19th century Manchester model, or some strikingly unequal Latin-American countries

Four definite "no" -- that is an emphatic negative answer to the question, whether the system functioning in China and Vietnam can be called "socialism" according to the criteria associated with the four interpretations described in the paper.

This is a *factual* observation and does not have any *normative* implications. In my eyes the label "socialism" is not a badge of honor. I am not the advocate of Leninist socialism. I do not discuss the issue whether China or Vietnam "deserve" to be called socialist countries, or whether they departed from the only true way of Leninism. Similarly, I am not the advocate of social democracy, and therefore do not blame these countries for being far from the social democratic pattern of parliamentary democracy and welfare state.

"Socialism" is not a registered trademark. Nobody has the right to give a mandatory and exclusive definition, claiming that his definition is the only legitimate one. If the Chinese or the Vietnamese leadership insists on calling their own regime "socialist", no one can deny their right to do so. Of course, it remains an intriguing question for scholars, specializing in the study of ideologies, symbols, rituals, political rhetoric, what is the motivation for that insistence? These leaders took the risk of departing from the Leninist route, and did not join the social democratic route either, but decided to follow a new path in their *deeds*. But why are they so conservative or stubborn in maintaining the old *words* and continue to carry the old labels? Scholars specialized in the study of ideologies will probably have an answer. They might point out that *words do*

*matter*. In the political sphere (or perhaps also in private life) it is often much easier to turn around in your practical actions than to confess that you have become a renegade to your earlier beliefs and values. Turning from Saulus to Paulus -- openly admit the change of faith and accept all the consequences -- that is a rare, indeed very rare exception in political history.

Intellectuals who make their living from written or spoken words are keen to clarify concepts. But life goes on in the midst of conceptual confusion. In this paper I have tried to offer some conceptual clarification. Whatever the result, our discussion about Chinese and Vietnamese reforms must get started even if we were unable to decide how to call the present system prevailing in the two countries. In the papers that follow we are going to discuss not how the changes are *called*, but what the true nature of the changes *is*.

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