Erasmus Journal for Philosophy and Economics,
Volume 11, Issue 2,
Autumn 2018, pp. 124-143.
https://doi.org/10.23941/ejpe.v11i2.337

Is the Market Wage the Just Wage? A Reassessment of Factor Pricing and Distributive Justice

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Abstract: Do markets generate a 'just' wage? The answer to this question will depend upon the particular theory of the market that the political economist employs. By comparing actual labor markets with the neoclassical theory of competitive equilibrium as its normative benchmark, Joseph Heath (2018) argues that factor pricing is orthogonal to normative issues such as distributive justice. We argue that Heath's conclusion, though not invalid, is misplaced since it is directed towards a *model* of the market rather than the market itself. Though, indeed, classical political economists and early neoclassical economists failed to deliver an *explicit* theory of distributive justice, what Heath overlooks is that implicit to their understanding of the market process was an *institutional theory of distributive justice*. On the basis of this theory, we evaluate distributive justice on the degree to which institutions generate the conditions necessary for individuals to realize and increase their marginal product of labor. By arguing in terms of an equilibrium, Heath fails to consider the more relevant question of a *comparative institutional nature*, which is to understand under which institutional conditions a just wage can be *discovered*. Therefore, Heath evaluates factor pricing without accounting for the institutional conditions from which factor prices emerge in the first place.

Keywords: income distribution, institutions, Joseph Heath, marginal productivity theory

JEL Classification: B1, D33, D41, P51

AUTHORS' NOTE: The authors would like to thank the referees for their helpful comments and feedback on an earlier draft of this paper. Any remaining errors are entirely their own.

I. INTRODUCTION

What are the normative implications of positive economic science regarding the justice of factor pricing in labor markets? About this question, Joseph Heath (2018) asks: are markets able to deliver a just wage? For philosophers, economists, and social theorists in general, the analysis of social phenomena is never about a choice between utilizing theory and not utilizing theory as a tool to understanding the real world. Because all facts are theory-laden, the relevant question is whether or not the social theorist is utilizing an articulated and defended theory or an unarticulated and non-defended theory (Popper 1972). Therefore, the answer to any empirical question will depend upon the particular theory of the market that the political economist employs.

Heath argues that factor pricing in markets is orthogonal to normative issues such as distributive justice. "My central contention", Heath states, "will be that markets are structurally unable to deliver 'just' wages, according to any everyday-moral understanding of what justice requires in cooperative interactions—and so we should stop trying to either defend or criticize them in those terms" (4). He continues: "Left to its own devices, there is no reason to think that the labour market will tend to produce wages that are 'fair' or 'just'. And to the extent that we do allow market forces free reign in this domain, it is not because we consider the outcomes to be satisfactory from the standpoint of distributive justice, it is that we regard them as desirable from the standpoint of efficiency" (27-28). Implicit in Heath's argument is a theory of markets defined in terms of equilibrium outcomes, not in terms of processes of adjustment towards equilibrium.

Based on this implicit theoretical paradigm, we argue that Heath's conclusion, though not invalid, takes for granted the institutional prerequisites that allow factor pricing to emerge in the first place. It would indeed be fair to say that classical political economists and early neoclassical economists had failed to deliver an *explicit* theory of distributive justice. However, what Heath overlooks is that, implicit in the understanding of the market process by economists, from Adam Smith to Carl Menger to Alfred Marshall, was an *institutional theory of distributive justice*,[1] based upon private property and freedom of

[1] Our claim here is not that every single classical political economist or early neoclassical economist adhered to the institutional theory of justice that we explain in this paper. Among the classical economists, Menger writes that the "labor-friendly attitude appears least in Robert Malthus, the representative among the classical economists of agrarian interests" (Menger [1891] 2016, 477); a notable exception

contract under the rule of law. Their commitment to the institutional justice of the market economy stems from the belief that the market channels competitive behavior away from negative-sum games in the distribution of wealth into positive-sum games that generate an ever-growing pie of wealth for the market process to distribute. More importantly, they believed that the violation of these institutional arrangements, particularly of the rule of law, was an injustice precisely because violations of the rule of law *increased* income inequality at the expense of the poor and least advantaged in society. By granting special monopoly privileges to interest groups that protect them from market competition, it also places legal handicaps on the least advantaged in society by excluding them from participating in the gains from productive specialization and social cooperation under the division of labor. The outcome of such injustice is an increase in income inequality and a failure of laborers to realize, as well as increase, their marginal productivity through productive specialization under the division of labor. This argument, unfortunately, became overshadowed by an equilibrium-focused analysis of markets beginning in the first half of the 20th century. Therefore, Heath's argument is misplaced, since it compares real-world labor markets with a perfect model of the market. The more relevant comparison is one of a *comparative institutional nature*.

Our assessment of Heath's argument is not meant to be a particular indictment or critique of Heath *per se*. Rather, we utilize his argument as representative of a broader issue that emerged in the intellectual history of price theory in the 20th century—that is, the adoption and use of a perfectly competitive equilibrium as a normative benchmark to assess real-world markets. Heath's conclusion that markets are unable to deliver just wages does indeed follow from analyzing markets in

among early neoclassicals would be Oskar Lange and Abba Lerner, who used the tools of neoclassical marginal analysis to develop the model of market socialism. Though dissecting and analyzing the degree to which each would agree with our claim would indeed be a worthy pursuit, this is beyond the scope of our paper. Our point is merely to introduce the notion that among classical political economists and early neoclassicals, a concern for distributive justice was not completely absent. Moreover, our claim is meant to draw attention to the overlooked notion that classical economists, as well as early neoclassicals generally studied markets as processes under alternative institutional arrangements, not in terms of equilibrium states, the latter implied by Heath (see Machovec 1995). Thus, from their positive analysis of markets, it would not be unfair to claim that classical political economists and early neoclassical economists, including Hayek, were able to draw the normative implications of market processes under alternative institutional arrangements, particularly with regards to distributive justice.

terms of efficiency. Efficiency refers to a market outcome in which all the gains from trade and innovation have been exhausted, but in a market that is efficient, institutions—such as private property and freedom of contract under the rule of law—become irrelevant. As such, we use his argument as a foil with which to critically examine what happens to the analysis of markets when institutions are pushed out of focus. Heath's argument and ultimate conclusion that the market wage is not a just wage is emblematic of how analysis in terms of static equilibrium distracts us from the important elements of evaluating market performance, namely, the role of institutions.

Therefore, Heath's utilization of this static criterion of efficiency overlooks some more important questions: (1) What are the institutional conditions that generate a tendency towards an efficient outcome in the first place; and during this *process*, (2) how can such a tendency (which generates factor prices and shares of income) be consistent with delivering distributive justice? By conceiving public policy regarding income distribution, factor pricing, and just wages in terms of dynamic processes of adjustment, we can see that the relevant question of just wages is not about particular distributive outcomes, but about particular sets of comparative institutions that engender, or mitigate, just patterns of income distribution through factor pricing, including wages.

II. DISTRIBUTIVE JUSTICE AND THE MARKET PROCESS: FROM SMITH TO MARSHALL

Given that Heath takes modern neoclassical price theory as his theoretical standpoint to assess whether market wages are just wages, it is important to first understand how and why the particular theoretical paradigm of equilibrium analysis in economics first emerged. In his assessment of classical political economy, James Buchanan (1991) argues that the doctrines of Adam Smith and his followers had delivered an explicit theoretical system and a guide for public policy that both promised and delivered the simultaneous achievement of individual autonomy, generalized material prosperity, and peaceful social cooperation.

It is important to note here, however, that economists, such as Adam Smith, Carl Menger, and Alfred Marshall, were indeed defenders of the market economy, but were not advocating a public policy conclusion *per se*; rather, their public policy conclusions were a by-product of a particular understanding of economic science. That is, the classical

understanding of the market process was a dynamic process of adjustment, in which factor prices serve as guides to exchange and production. Guided by market prices, entrepreneurs *discover* the most valued uses of land, labor, and capital and in doing so, generate an equalizing *tendency* in factor pricing through arbitrage opportunities—known as the 'Law of One Price,' or Stanley Jevon's 'Law of Indifference' (Jevons [1871] 1965). This allocative discovery process generates patterns of income distribution as an unintended result of the pursuit of profits and the avoidance of losses by entrepreneurs. Indeed, it is "the alert business man" that must deploy his judgment to push investments in an equilibrating direction (Marshall [1920] 2013, 298). The presence of entrepreneurial profits, in turn, engender market processes that also generate a *tendency* to attract entry by competing entrepreneurs, which not only erode monopoly power, but also erode profits down to zero, thus generating a *tendency* towards an equalization of returns between all factors of production, such as land, labor, capital, and entrepreneurship.[2]

"Uncertainty and entrepreneurship," Machovec states, "were central to the classicals' understanding of the market process—a centrality that is irreconcilable with the equilibrium vision that succeeded it" (1995, 158). Before the mid-20th century, the notion of market efficiency, which had come to imply the neoclassical notion of a static equilibrium of 'given' resources according to 'given' technology and consumer preferences, was irrelevant, since the theoretical emphasis was to demonstrate the very process by which these "givens" come to be 'known' by decentralized decision makers. Therefore, the neoclassical standpoint of efficiency really begs the important question. Moreover, Adam Smith's theory of the invisible hand was an *institutionally-contingent theory*. The notion that individuals acting independently in the pursuit of their goals will generate unintended outcomes consistent with individual liberty, peace, and economic prosperity only occurred within a context of private property and freedom of contract under the rule of law. Although classical liberal political economists had demonstrated the effectiveness of a 'system of natural liberty' to generate peace and economic prosperity, it had failed to deliver a convincing argument regarding distributive justice to critics of the

[2] Boettke and Candela have argued that legal institutions are a 'fifth factor of production' (2014), which structures the payoffs of entrepreneurs in organizing land, labor, and capital towards productive or unproductive purposes, and therefore guides expectations about the organization of production.

market process (Buchanan 1991). "In their explanations of the workings of a competitive economy the most striking deficiency of the classical economists," Stigler argues, "was their failure to work out the theory of the effects of competition on the distribution of income" (1957, 5).

However, this vulnerability in explicitly accounting for distributive justice was not due to any lack of concern for the poor or for income inequality. Indeed, Adam Smith critiqued the mercantilist policies of his time for *perpetuating* income inequality, since the use of political discretion in granting monopoly privileges would unintentionally generate invisible-hand processes that benefit politically-connected producers at the expense of the poorest and least advantaged in society. "The patrimony of a poor man lies in the strength and dexterity of his hands," Smith states, "and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour, is a plain violation of this most sacred property", namely property in his own labor (Smith [1776] 1981, 138).

Understood this way, Smith, the classical economists, and the early neoclassical economists, had developed an implicit theory regarding the market's ability to deliver distributive justice. However, this *institutional* theory later became overshadowed by critiques about the injustice of the market due to exploitation, monopoly power, external effects, public goods, and macroeconomic instability due to speculative behavior. But for our purposes, the critical question was not the inefficiency of the market *per se*, but the injustice of the market in terms of distributive justice. Workers lack bargaining power, and thus their wages would be bid down to subsistence levels, while the monopolist-capitalist would accrue profits and amass wealth. This is basically the argument of the critics of the 'Gilded Age', and it was not limited to Marxist critics of capitalism. It was an argument that was accepted across the intelligentsia in Europe and the United States, even among the most well-trained economic thinkers of the age. As James Buchanan highlighted, though classical political economists were able to demonstrate the complementarity of peace, prosperity, and individual liberty with a market economy, their demonstration implied nothing directly about the *distributive justice* of the market, or more specifically, whether market wages paid to laborers are indeed just wages.

However, to claim that the classical political economists and early neoclassical economists said nothing directly about distributive justice does not mean they had not *implicitly* made a case for economic justice

in terms of institutions and factor pricing. From the standpoint of efficiency, Heath argues that there exists an inequality-efficiency trade-off, but to attribute this same trade-off to Smith would misconstrue his understanding of markets and their normative implications. There can be no question for economists, from Smith to Marshall, whether less inequality was a desirable goal. As George Stigler has written elsewhere, economists since Adam Smith "have always been opposed to inequality of income" as a policy objective (1949, 1). And indeed, the tendency towards greater efficiency in the market process *complemented* the objective of greater income equality. Consider the following quote from Adam Smith:

> The policy of Europe occasions a very important inequality in the whole of the advantages and disadvantages of the different employments of labour and stock, by restraining the competition in some employments to a smaller number than might otherwise be disposed to enter into them. The exclusive privileges of corporations are the principal means it makes use of for this purpose. The exclusive privilege of an incorporated trade necessarily restrains the competition, in the town where it is established, to those who are free of the trade. ([1776] 1981, 135)

Carl Menger reinforces this point by Adam Smith, and classical political economy in general, by arguing the following:

> In every conflict of interest between the rich and the poor, the strong and the weak, Smith sides *without exception* with the latter. I use the term "without exception" with proper consideration, as one cannot find one single instance in the works of Smith in which he represents the interests of the rich and the powerful against the poor and the weak. Smith fights against the industrial policy of the mercantile system because it favors the industries of the rich while neglecting and oppressing those branches of industry which guarantee the sustenance of the poor and the weak. He demands free mobility because its limitation hurts labor much more than capital, as the rich merchant can obtain the right to settle down anywhere much easier than the poor craftsman. He is against the regulation of the so-called legal settlement laws, because they primarily hurt the poor and violate natural liberty and justice when expelling someone from a parish who has chosen the very place as his residence; he favors high wages, in which he sees both an imperative of humanity and of prudence. ([1891] 2016, 475-476, emphasis in original)

Likewise, Alfred Marshall states:

> Any diminution of [the inequalities of wealth] which can be attained by means that would not sap the springs of free initiative and strength of character, and would not therefore materially check the growth of the national dividend, would seem to be a clear social gain. ([1920] 2013, 594)

The relevant question, then, is what are the most effective means to reduce income inequality *and* generate economic prosperity? For economists from Smith to Menger to Marshall, free markets, properly understood as an institutional framework of *private property and freedom of contract under the rule of law*, was the most effective means for eliminating income inequality and generating economic wealth. This entailed the elimination of legal barriers to entry and monopoly privileges which perpetuate income inequality and impede the discovery of profit opportunities that otherwise would generate productivity gains among the least advantaged in society.

III. PRICE THEORY, DISTRIBUTIVE JUSTICE, AND THE JUST WAGE

Can we then conclude from economic theory that markets are unable to deliver just wages? According to Heath, this is the case, but this answer follows from a particular understanding of the allocative functions of prices. As Heath argues, wages are synonymous with the price of labor, but it does not necessarily follow that prices "can be understood as simply a quantitative 'score' assigned to a particular use of a resource" (2018, 5). Such a definition can be highly misleading, and therefore requires unpacking.

Wages, like any price, are an exchange ratio, i.e. the terms in which two goods are exchanged. In a market economy, such prices are denominated in terms of money, such that individuals exchange labor services for monetary payment of such services. The institutional prerequisite for exchange, however, are well-enforced and well-defined property rights in the factors of production. Without the ability to exchange, factor prices will never emerge in the marketplace. Therefore, prices are a necessary, though not a sufficient, condition for a just pattern of income distribution.

Unfortunately, this understanding of markets in terms of processes of price formation became eclipsed by an emerging neoclassical paradigm in the early 20th century. As a result, the earlier understanding

of prices as guides to production within an institutional framework of private property and freedom of contract under the rule of law transformed into a neoclassical understanding of prices as *sufficient statistics*, one in which factor prices reflect equilibrium valuations. Specific to labor markets, what this implies is that wages reflect the full opportunity cost of individual's labor services, since under conditions of equilibrium, perfect information regarding the distribution of income is completely given. Heath's understanding of prices as a 'score' corresponds to the notion that prices are *sufficient statistics* for allocation problems, but this is a misrepresentation of market prices, one which can have misleading public policy implications regarding income distribution and central planning.

Let us take, for example, how the early neoclassicals confronted criticisms of unjust income distribution under capitalism. Under the assumption that factor prices under equilibrium reflect the full opportunity cost in their next-best alternative use, early neoclassical economists, such as John Bates Clark (1899) and Phillip Wicksteed (1894), defended the justice of income distribution through the market mechanism. Justice according to the early neoclassical economists was defined in terms of market outcomes that approximate the marginal valuation of the productive contribution of each factor of production, based upon the application of Euler's theorem to the distribution of income.

In terms of the economic distribution of wealth, Euler's theorem states that, under the assumption of constant returns to scale, the separate marginal value products of each factor of production will exhaust the total value of output. Therefore, incomes generated in the marketplace will approximate that which would prevail under conditions of equilibrium. The exhaustion of payments from total output to factors of production had both positive and normative implications. Positively speaking, Euler's theorem illustrated mathematically that the share of total output accrued to owners of capital is derived from its marginal contribution to output. Normatively speaking, this implies that the redistribution of income is unjustified, since the income paid to capitalists is not a result of exploitation or theft of labor income.

Indeed, Heath acknowledges several problems with neoclassical theory. As he argues, "'marginal productivity' does not mean what many people think it means, and certainly does not correspond to any plausible conception of 'how much a worker produces'" (2018, 14).

Therefore, we should conclude that “the ‘marginal product’ of labour is a hypothetical construct, one that does not exactly correspond to any of our intuitive ideas about what an individual can be said to have contributed” (12).

That each factor of production is paid according to its marginal product under equilibrium conditions is indeed a hypothetical construct. The purpose of such a hypothetical construct is to contrast such equilibrium conditions with the sequence of processes that are generated and the institutions necessary to *discover* what share of total product a laborer has contributed. The purpose of equilibrium logic is to provide the economist a disciplining device and act as a foil, which is “supposed to shed light upon the real world by method of contrast” (Cowen and Fink 1985, 866; see also Boettke 1997). For example, in a world in which all data is frozen, the induced variables of the market (prices, profit/loss, and resource ownership) would dovetail perfectly with the underlying variables of the market (tastes, technology, and resource availability). In such a case, institutions are irrelevant since uncertainty regarding factor pricing would not exist. Therefore, analyzing equilibrium as a method of contrast, or a foil, helps to shed light on the institutions and the equilibrating tendencies that emerge as a by-product of such institutional incentives. Economic theory is a science of tendencies and directions, not a science of exact point prediction.

However, Heath goes on to point out a problem with marginal productivity theory by stating that “once two or more individuals begin to work together cooperatively, it becomes increasingly difficult to determine how much each person has contributed, especially if the forms of labour involved are heterogeneous” (2018, 10). Therefore, “everyday notions of what each individual has ‘contributed’ to the production process begin to fail us” (10). However, this statement does not demonstrate why markets cannot deliver a just wage. It would be more precise to say that Heath has only demonstrated a failure of a particular model of the market, analyzed in terms of equilibrium, to explain the process by which just wages are discovered and paid to laborers. This is because the “problem of economic organization, the economical means of metering productivity and rewards, *is not confronted directly in the classical analysis of production and distribution*. Instead, that analysis tends to assume sufficiently economic

or zero cost means, as if productivity automatically created its reward" (Alchian and Demsetz 1972, 778, emphasis added).

However valid Heath's statement regarding joint production may be, under conditions of disequilibrium, to employ marginal productivity theory as a hypothetical construct and then argue that real markets are suboptimal by comparison, since they fail to efficiently price the marginal contribution of each worker, is an example of a "Nirvana Fallacy" (Demsetz 1969). Under conditions of equilibrium, since all gains from trade are exhausted, the implication here is the existence of perfect information regarding the distribution of income, which is predetermined by fixed and given institutional, technological, and resource constraints. "But this way of perceiving the society's economic problem as an allocation problem implies, in turn, that the problem of distribution is *a problem of sharing out a given pie*", which by logical construction is also known to a 'distributor' who wishes to redistribute income (Kirzner 1988b, 177, emphasis in original). Heath concludes his paper by stating that the "market has one job to do, and it does that job very well. Producing 'just' wages, however, is not that job" (2018, 31). If by 'market' Heath is implying a perfectly competitive market, in which information is perfectly given, would not a distributor be able to adjust prices according to what is just?

IV. ECONOMIC CALCULATION AND JUST WAGES

Based on Heath's remarks regarding the possibility of economic calculation under market socialism, the answer to the question above would have to be 'yes', revealing a contradiction in Heath's argument. As he states, "the 'socialist calculation' debate of the early 20th century was quite illuminating, in that it showed how an entirely planned and obviously artificial order might still choose to use the principle of scarcity pricing as a basis for allocating resources and goods" (7). Consistent with Heath's notion that prices assign quantitative scores in their valuation of labor, he further states that "we are concerned with the situation in a 'complex' economy" (6).

Such a fundamental misunderstanding of the informational role of prices in an economy implies that questions of efficiency, to say nothing about just wages, are simply a computational issue, one of gathering objective information of the relative scarcity of labor and their marginal contribution to total output. It implicitly assumes that the economic knowledge required to calculate the relative scarcity of labor in

alternative uses, and therefore to 'assign' a price, is knowledge that exists independent of an institutional context of private property in the means of production. This notion of prices as sufficient statistics to an allocation problem, not as guides to future decision-making, is implicit in the argument made by Oskar Lange and Abba Lerner in their model of market socialism, developed to counter Ludwig von Mises's critique regarding the impossibility of economic calculation under socialism.

It was during the Socialist Calculation Debate of the 1920s-1940s that economic theory evolved from what was previously a shared understanding of the market among early neoclassical economists into two distinct paradigms of the market, perceived in terms of (1) a static model of general competitive equilibrium, and (2) a dynamic process of entrepreneurial discovery (Kirzner 1988a, 3; see also Boettke and Candela 2017). Each paradigm shaped the way not only how the market socialists and the Austrians, respectively, understood the solution to the problem of economic calculation, but also how they interpreted each other's arguments with respect to the solution to the problem (see Lavoie 1985). Economic calculation is a procedure whereby economic actors, guided by market processes, are able to sort out from the array of technologically feasible projects those that are economically viable. It is a discovery procedure through which preferences are communicated through prices so that the pattern of resource use tends toward efficiency.

The standard account of the socialist calculation debate, which Heath is following, was one in which Lange and Lerner stressed the formal similarity of capitalism and socialism under static assumptions and believing this to have been the analytic framework of the whole controversy. In the belief that socialism, if it was to achieve its claimed outcomes of advanced material production, must satisfy the formal conditions of economic efficiency stipulated by marginalist principles, Frederick Taylor, Frank Knight, H. D. Dickinson, and Abba Lerner began developing an argument that used modern neoclassical economics to ensure the efficiency of socialist economic planning. Using the same line of neoclassical reasoning, Oskar Lange was able to formulate his critique of Mises ([1920] 1975).

In deploying the formal similarity argument, Lange provided the following blueprint. First, allow a market for consumer goods and labor allocation. Second, put the productive sector into state hands but provide strict production guidelines to firms. Namely, inform managers

that they must price their output equal to marginal costs, and produce that level of output that minimizes average costs. Adjustments can be made on a trial and error basis, using inventory as the signal. The production guidelines will ensure that the full opportunity cost of production will be taken into account and that all least-cost technologies will be employed. In short, these production guidelines will ensure that productive efficiency is achieved even in a setting of state ownership of the means of production.

Lange went even further in his argument for socialism. Not only is socialism, by mimicking the efficiency conditions of capitalism, able to theoretically achieve the same level of efficient production as the market. It would also outperform capitalism by purging society of monopoly power, business cycles, and income inequalities that plague real-world capitalism. Moreover, since the means of production would rest in the hands of authorities, market socialism would also be able to pursue egalitarian distributions in a manner unobtainable with private ownership. In the hands of Lange (and Lerner), neoclassical theory was to become a powerful tool of social control. Modern economic theory, which Mises and Hayek had thought so convincingly established their argument, was now used to show that they were wrong. But this entirely misses the point about the role that economic calculation plays in a market economy. As Hayek argues:

> Professor Lange and particularly his editor now seem inclined to suggest that the demonstration that the formal principles of economic theory apply to a socialist economy provides an answer to these critics. The fact is that it has never been denied by anybody, except socialists, that these formal principles ought to apply to a socialist society, and the question raised by Mises and others was not whether they ought to apply but whether they could in practice be applied in the absence of a market. It is therefore entirely beside the point when Lange and others quote Pareto and Barone as having shown that values in a socialist society would depend on essentially the same factors as in a competitive society. (1940, 126-127)

Our point here is not to recount the socialist calculation debate for its own sake, but to make a broader point about what Heath implicitly takes for granted regarding the evolution of price theory and its normative implications. During the late 19th and early 20th century, the particular normative implications that Heath makes regarding the justice of factor pricing under capitalism can be traced to this period,

and remains among economists to this day. During this same period, however, the "truth is that there was, among most economists (Austrian, Marshallian, or Walrasian) in the early twentieth century, a superficial, shared understanding of markets that submerged important distinctions that would become apparent only much later. In this shared understanding, there coexisted elements of appreciation for dynamic market processes and elements of appreciation for the degree of balance—the degree of equilibrium held to be achieved by markets" (Kirzner 1988a, 2). By the 1940s, however, neoclassical economic theory, by its defenders and critics alike, became based upon an analysis of the formal conditions of competitive equilibrium.

The greatest casualty of the socialist calculation debate was the focus on the institutional framework of a market economy, the neglect of which assumes away not only problems of how a market can ever become efficient, but also whether or not factor pricing will ever be just. As Hayek wrote, the "assumption of a perfect market in this sense is just another way of saying that equilibrium exists but does not get us any nearer an explanation of when and how such a state will come about. It is clear that, if we want to make the assertion that, under certain conditions, people will approach that state, we must explain by what process they will acquire the necessary knowledge" (1937, 45).

Hayek's central point was that, absent certain institutions and practices, the process that brings about the coordination of plans would not take place.[3] Some alternative process would have to be relied upon

[3] Given our discussion regarding the relationship between the market and distributive justice, it is interesting to note that Hayek wrote the following (1967, 233): "[R]emuneration, in accordance with the value of a man's services, inevitably is often very different from what we think of his moral merit. This, I believe, is the chief source of the dissatisfaction with a free enterprise system and the clamour for 'distributive justice'. It is neither honest nor effective to deny that there is such a discrepancy between the moral merit and esteem which a person may earn by his action and, on other hand, the value of the services for which we pay him. We place ourselves in an entirely false position if we try to gloss over this fact or to disguise it. Nor have we need to do so". What would seem to be an indictment of the distributive justice of the market, and Hayek's apparent refusal to address such a potential critique, ironically reinforces our central argument. This is because when we consider the fact that in order for individuals to possess the knowledge that would be required to assess whether or not a just distribution of income was generated, according to theory of marginal productivity, the market would already have to be in equilibrium. Under equilibrium, perfect information regarding the marginal product of each factor of production would be given. Moreover, since Hayek understood markets as always being in disequilibrium, and never achieving perfectly competitive equilibrium, the value of one's services will not perfectly correspond to what they regard as just, or based on their moral merit. However, from a Hayekian perspective, this be can interpreted not as

for decision making concerning resources, and that process would by necessity be one that could not rely on the guides of private property incentives, relative price signals, and profit/loss accounting since the socialist project had explicitly abolished them. In other words, the *ipso facto* proposition of competitive equilibrium, that factor prices can be directly imputed from their derived demand in consumption goods, was irrelevant for the world outside of that state of equilibrium. The fact that leading neoclassical economists (like Knight and Schumpeter) had not recognized this elementary point demonstrated the havoc that a preoccupation with the state of equilibrium can have on economic science.

Unfortunately for Heath, it is not clear by his remarks that he is aware of this either. Because he is assessing the question of justice in factor pricing from a standpoint of static efficiency, he analyzes neither the dynamic processes of adjustment that generate factor pricing nor the institutional conditions under which factor pricing emerges. The failure to account for institutional conditions of entry and exit generates two implications for an account of distributive justice in terms of market equilibrium, as put forth by Heath. First, it generates the presumption of monopoly power in markets when firms specialize without taking account the scope of competition in that market. Second, it also generates the presumption that such increasing returns to monopolists are therefore a zero-sum game, whereby monopolistic capitalists accrue 'unearned rents' that are undeserved and come at the expense of wages paid to exploited laborers.

To illustrate this point, let us examine Heath's analysis of the Wilt Chamberlain example famously provided by Nozick (1974, 160-164). As Heath states:

> The problem with this argument is not that it fails to justify the rate of wages under capitalism, but rather that it justifies too much, including too many different wage rates. Indeed, it comes close to saying that 'whatever is, is good'. For example, it fails to provide any basis for preferring the wage rate determined in a competitive market over one in which some party has significant market power. Indeed, while Nozick had much to say about the importance of exchange, he had nothing to say about the importance of competition—which is arguably the more important institutional feature of capitalism. And yet, the inability to find anything wrong

a moral critique of the free market itself, but as a critique of a particular understanding of free markets in terms of an equilibrium outcome.

with monopoly pricing is a fairly major deficiency in any normative reconstruction of capitalism (Heath 2018, 9).

"Thus," Heath further states, "the discussion gets sidetracked into a debate over the disposition of economic rents, while ignoring the more fundamental questions about the way that ordinary wages are determined in a market economy" (16). We do not wish here to defend Nozick. Rather, our point here is to illustrate that the claims that Heath makes in this quote can only follow from analysis of the market from a standpoint of static efficiency. Though, it is true that discussions of wages may get sidetracked into a debate over economic rents, in the Wilt Chamberlain case, it is highly relevant for distributive justice and the payment of just wages.

There is an important distinction to be made here between 'Ricardian rents' and 'monopoly rents' (Alchian 2006). Generally speaking, a rent is a payment above opportunity cost due to the scarcity of a factor of production. Specifically, a Ricardian rent is a payment above opportunity cost due to a *natural* scarcity that is derived from a superior skill or talent, whereas a monopoly rent is a payment above opportunity costs due to an *artificial* scarcity derived from government restrictions of entry into a market, in the form of licenses, regulations, or import tariffs. In both cases, such rents are accrued due to competition. Given the scarcity of such rents, competition for the accrual of rents will be ubiquitous, but the *form* of such competition, and its consequences for monopoly pricing, are by-products of the institutional incentives within which competition takes place.

In an open market where the conditions of entry and exit are open, it may be the case that at a certain moment in time, Chamberlain will accrue Ricardian rents without any government privilege. To conclude, however, that Chamberlain will always accrue such rents implies a fixed supply of his skills and talent. Such a conclusion rules out, that over time, the existence of such rents will create incentives for existing players to mimic the abilities of Chamberlain by investing in similar skills, as well as attracting new players from other sports. Such competition will not only include productive specialization but also a concurrent expansion of the market for basketball, as new consumers—i.e. the spectators—will be attracted to their 'product', which is the production of a more interesting game. The unintended result of this process is a positive-sum game, whereby the wages of all the basketball players rise, but competition will also induce an erosion of the rents

accrued to Chamberlain *relative* to other basketball players until they are zero, at which point Chamberlain is paid his opportunity cost. The outcome is efficient, but a by-product of this dynamic process of competition is justice, whereby no one is excluded from the opportunity to discover their productive potential. The normative implications of this market process is that for just wages to emerge, not only must referees be constrained to enforcing general rules that apply equally to all of the players of the game, but that such rules must allow for contestability of rents that neither discriminate nor privilege any one particular player or group of players.

However, let us now suppose that an alternative situation, in which general rules (which in the previous case were not intended to benefit any particular group of individuals) do not exist. Competition, as before, will exist, but the form in which Chamberlain competes will be different. Chamberlain now *discovers* an opportunity to earn higher wages by capturing the discretion of particular referees to call penalties against other players and exempt himself from particular rules. Chamberlain now earns a monopoly rent. By changing the rules of the game, however, there are now increasing returns to specializing in lobbying referees off the court relative to specializing in learning new basketball skills on the court. Having captured this monopoly rent, however, Chamberlain will still face competition from other players, but such competition will take the form of contestability over the rules.

The unintended outcome of this process will be 'efficient' in the sense that the players will expend resources lobbying until all the gains from such activity are exhausted. However, compared to the previous case where the rule of law was intact, the outcome will be a negative-sum game, since players in this game only expend resources to capture transfers of existing wealth, not to create new wealth. From a dynamic standpoint, even Chamberlain's rents will be eroded, not only from expending resources to maintain the favor of the referees, but also as the market for basketball shrinks as consumers flock to more interesting substitutes, such as football, baseball, or soccer. More importantly, however, the outcome will be unjust. Since by privileging Chamberlain with exemptions from the rules, he will earn higher wages and exercise monopoly power to the expense of the other players. Moreover, the injustice of such factor pricing results from legal discrimination that excludes the possibility of disadvantaged players from realizing their full productive potential.

V. CONCLUSION

Heath reveals some important shortcomings of the neoclassical model of perfectly competitive equilibrium, particularly with regard to questions of distributive justice. As he has argued, from a standpoint of efficiency, markets will be structurally unable to deliver just wages. But, it is important to highlight that Heath has critiqued the failure of a particular *model* of the market to deliver just wages, not the market properly understood as a process of equilibration within an institutional framework of private property and freedom of contract under the rule of law.

We are not claiming that we should abandon modelling or that markets are perfect; both will never be perfect. Like maps, models rely on omission as they cannot represent every detail of what we are explaining. Models are to be understood as articulate artefacts—compressed accounts of things in the world expressed in an appropriately specialized form and language. As such, economic narratives "*are built into the identity of the model from the start*" (Morgan 2012, 362, emphasis in original). However, if we implicitly build perfection into the identity of a model as an assumption of analysis, then we squeeze out of our analysis the very imperfections we are trying to explain, as well as the mechanisms and institutions that emerge to correct such imperfections.

By assuming away the entire problem of how the tendency towards an efficient distribution of income is generated, Heath also assumes away an analysis of the institutional conditions under which factor prices, as well as just distributions of income, are generated. By arguing in terms of equilibrium, Heath avoids the more relevant question of a *comparative institutional nature*, which is to understand the institutional conditions under which a just wage can be *discovered*. The most important implication that economists and philosophers can learn from Heath's argument is that making a case for the justice of the market process cannot be analyzed in an institutional vacuum.

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