

“The important role that *Rivalry and Central Planning* plays in explicating the study of market process theory cannot be overstated. In addressing the central debate in economic theory and philosophy of the 20th century—capitalism versus socialism—Don Lavoie details how the dynamic and competitive market process works and highlights the deficiencies of socialist planning in ways that the textbook model of the perfectly competitive economy fails to do. When I was the director of the Center for the Study of Market Processes (now the Mercatus Center), I considered Don’s work critical in our efforts to enlighten and educate students and scholars alike in the study of the competitive market process, the failures of socialism, and the frustrations of government interventionism; and I am thrilled to see a fresh publication of this book and consider it a testament to Don’s legacy as a scholar and a teacher.”

—Richard Fink, Founder and former Director of the
Center for the Study of Market Processes

“When it was first published in 1985, Don Lavoie’s revisionist account of the socialist calculation debate immediately became a seminal document in the Austrian revival. The book not only demonstrates the flaws of central planning but also shows why so many economists, in thrall to equilibrium theorizing, missed the essential points of the Austrian critique. The Mercatus Center’s reissuing of this important book is very welcome indeed.”

—Bruce Caldwell, Director of the Center for the History
of Political Economy at Duke University

“*Rivalry and Central Planning* was an important book when it was first published in 1985, and 30 years later it is still well worth scholarly attention. As the first detailed examination of the economic calculation debate from an Austrian perspective, Lavoie not only demonstrated the shortcomings of the socialist position but also provided a critique of much of mainstream economic theory. His emphasis on the central importance of rivalry among competitors captured the central feature of a market economy that leads to innovation and economic growth. It is a classic, and I am delighted that this book will now once again be in print for a new generation of economists.”

—Karen Vaughn, author of *Austrian Economics in
America: The Migration of a Tradition*

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RIVALRY AND CENTRAL PLANNING

The socialist calculation debate reconsidered

Don Lavoie

foreword by Peter J. Boettke and Virgil Henry Storr



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For my mother,
Ruth Evelyn Knight Lavoie,
for instilling in me the love of reading

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Foreword to the Mercatus Center Edition

Don Lavoie's *Rivalry and Central Planning: The Socialist Debate Reconsidered*, originally published by Cambridge University Press in 1985, was a vital contribution to the scholarly literature in comparative economic systems and the Austrian school of economics at a most critical time. Within comparative economic systems, Lavoie reopened a debate that most in the field thought was settled and made a compelling case that the dominant opinion about who had won the calculation debate was wrong. The market socialists, contrary to the popular view at the time, did not answer the Austrians' chief concerns about the challenges associated with rationally allocating resources in a socialist commonwealth.

Lavoie's account of the socialist calculation debate reminded the new generation of Austrians of the uniqueness of their understanding of the market process and, specifically, of the importance that Austrian economists place on the "knowledge problem" and the capacity of economic actors within a competitive market to discover the knowledge that they need to make rational economic decisions. By revisiting the calculation debate with the aid of Lavoie's *Rivalry and Central Planning*, scholars and students working within the history of thought, comparative economic systems, economic methodology, and Austrian economics can learn a great deal about the key contributions of the Austrian school to our understanding of how markets work, and some of the key shortcomings of mainstream approaches to understanding markets.

II

The calculation debate began in 1920. Ludwig von Mises famously argued in "Economic Calculation in the Socialist Commonwealth" ([1920] 1990) and *Socialism: An Economic and Sociological Analysis* ([1922] 1981) that socialist societies would not and could not be prosperous

societies. This is not because socialists lacked the motivation or morality to achieve the socialist utopia but because rational economic calculation is impossible under the socialist system. Socialism calls for the elimination of private property in the means of production as a way to move beyond the alienation and exploitation that supposedly characterizes capitalist economic relations. Unfortunately, Mises argued, replacing private property with collective property—and its corollary, replacing decentralized economic decision-making with comprehensive economic planning—also eliminates the only mechanism that allows decision makers to distinguish between economically viable plans and wasteful projects.

Central planners in a socialist society simply lack the tools that they need to do their jobs. Absent private ownership of the means of production, there can be no market for the means of production. If there is no rivalry over the means of production, no money prices that reflect relative scarcities will emerge. Without money prices that reflect relative scarcities, it is impossible to determine whether or not economic projects are profitable (i.e., whether the benefits associated with a project are higher than the resources that must be expended pursuing that project).

Central planners simply have no means at their disposal to decide whether or not a project is too costly to pursue and which of the various technologically feasible strategies that might be adopted are actually economically feasible. Suppose, for instance, that we have to decide between a plan to build and sell houses made out of brick or one to build and sell houses made out of platinum. Let us assume for sake of argument that platinum is the technologically superior building material for houses. Note, however, that even assuming technological advantages does not answer the question as to what is the most *economically* valuable use of a resource. Platinum is much more scarce than brick and can be put toward much more socially beneficial uses than as a building material. In a capitalist economic system, the relative scarcity of platinum versus brick will be reflected in a significantly higher relative price for platinum versus brick. As a result, platinum houses are likely to be cost prohibitive. While it is possible that socialist societies might develop systems to avoid making errors as extreme as using platinum to build houses, they have no mechanism for ensuring that resources tend to flow to their highest valued use. Economic calculation is the critical mechanism for sorting out

among the technologically feasible production projects those that are economically viable from those that are not.

Socialism, then, was unworkable because it abolished the price system and with it the ability of individuals to learn about the relative scarcity of disparate goods and services. Several years later, Oskar Lange and Abba Lerner attempted to answer Mises's challenge by devising a system that would guide the use of resources in a socialist economy and that was more efficient than capitalism. In the simplest version of the model, the Central Planning Board (CPB) would simply instruct the managers of state-owned enterprises to use the combination of inputs that a firm in the competitive market would use and set output at the level that a firm in the competitive market would have produced. By requiring state enterprises to adopt a few simple rules—marginal cost pricing and producing at minimum average costs—and relying on adjustments by the CPB, Lange and Lerner argued, the problems that hamper rational economic calculation under socialism can be overcome. Lange and Lerner thought their solution was not just theoretical but a practical guide to an improved “better” world. In their minds, real-world capitalist economies suffered from the problems of monopoly and recurring industrial fluctuations, both of which would be eliminated in their economic planning policy scheme.

Although Mises, as well as Hayek and Robbins, criticized the solution proposed by Lange and Lerner, most in the economics profession believed that Mises, Hayek, and Robbins lost the debate. Socialism, it was believed, could perform as well as capitalism in theory and might outperform capitalism in practice, in light of the deviations between real world capitalist systems and the theoretical representations of the system. Mises and Hayek never acknowledged that they “lost” this debate in the 1930s and 1940s, and instead insisted that (a) Lange and Lerner (and other models of “market” socialism) actually conceded the fundamental point about the necessity of the market and the price system for the coordination of economic activity, and (b) reflected the confusion caused by the preoccupation among economic theorists with equilibrium end states rather than the processes of exchange and production that produce the coordination of economic activity.

It is not an overstatement to assert that Lavoie's *Rivalry and Central Planning*, a thorough, book length treatment of the theoretical issues that surrounded the calculation debate, overturned the standard

interpretation of the debate.¹ It turned out that Mises, Hayek, and Robbins were right, after all. Although the reviewers of the book were not uncritical, most agreed that the book was a significant entry into the debate. Bideleux (1986, 564, 567), for instance, described the book as “absorbing and very clearly written” and concluded “Lavoie has presented cogent and stimulating arguments against socialist systems of central planning.” Similarly, Balinky (1988, 674) has described *Rivalry and Central Planning* as “a scholarly and reasonably written treatise.” Also, as Murrell (1987, 337) states, “Lavoie’s book is the most complete record written to date of this debate.” Moreover, scholars within the field of comparative economic systems seriously engaged *Rivalry and Central Planning* and tended to view it as an excellent review of the key issues surrounding the debate. It convinced at least two major leading figures to conclude that the Austrians were right about socialism (see, for instance, Kornai 1986; Heilbroner 1990). And, amongst Austrian economists, Lavoie’s book is viewed as the “definitive account of the debate” (see, for instance, Kirzner 1988). The book was also frequently cited and spurred additional research into the workability of the socialist alternative to capitalism.

Admittedly, the timing of *Rivalry and Central Planning’s* publication was critical to its success. By the mid-1980s, socialist regimes throughout the world were engaged in continuous reform measures to address the dysfunctionalities in their economies. Considering Gorbachev’s *perestroika*, Deng Xiaoping’s “poverty is not socialism” reforms, and all the efforts at fundamental economic change in Hungary and Poland, it was obvious that the traditional approaches to improving socialist economies were extremely wanting. Socialist regimes uniformly had militarized their economies, produced bloated bureaucracies, and trapped their citizens in a descending spiral of economic deprivation and political tyranny. Just as the stagflation of the 1970s had led to a fundamental rethinking of the then conventional consensus in macroeconomics, the worldwide failure of socialist regimes to deliver on their promises led to a fundamental rethinking of the core of comparative economic systems theory and history. Don Lavoie produced the most thorough investigation as to why such a rethinking must take

¹ For a documentary history of the debate throughout the 20th century see Boettke (ed), *Socialism and the Market: The Socialist Calculation Debate Reconsidered*, 9 volumes (2000).

place and what lines that rethinking should follow after establishing a new theoretical grounding for the field. Understanding a dynamic and thriving economy requires a theoretical framework that appreciates the economy as a continually adapting and adjusting system, a system of discovery and learning, and a system of entrepreneurial alertness and innovation.

However, the book did have two major criticisms. Despite his praise of the book, Bideleux chided Lavoie for not addressing the workers' management system and its experience in Yugoslavia. On the other hand, and again despite praising the scholarly contribution of the work, Tom Bottomore challenged Lavoie's understanding of the Soviet experience. Both Bideleux and Bottomore thought that theoretically and empirically the connection between economic deprivation and political tyranny in the socialist model and experience was a consequence of perversion of the socialist doctrine and was solved by more consistent application of socialist doctrine. They thought that a better historical account of the Yugoslavian and Soviet experiences would show that success was indeed possible, and any failures were due to factors divorced from the application of the doctrine.

Two of Lavoie's students, however, would answer these critiques. David Prychitko provided the answer to the Bideleux critique of Lavoie and demonstrated in his work the continuing relevance of the economic calculation argument for decentralized worker managed systems.² He did not deny the Yugoslavian system suffered from incentive issues, but Prychitko's analysis focused on the knowledge problem that must be confronted in even decentralized systems with respect to investment decisions and the coordination of exchange and production throughout an economic system. Similarly, Peter Boettke provided the answer to Bottomore by examining the intellectual history of Marxism–Leninism and demonstrating the tight connection between the aspirations of the Soviet experiment and the policies chosen by the original Bolshevik planners.³ Boettke also detailed the

² See Prychitko, *Marxism and Workers' Self-Management* (1991); Prychitko and Vanek (eds) *Producer Cooperatives and Labor Managed Systems* (1996); and Prychitko, *Markets, Planning and Democracy* (2002).

³ See Boettke, *The Political Economy of Soviet Socialism: The Formative Years, 1918–28* (1990); Boettke, *Why Perestroika Failed: The Politics and Economics of Socialist Transformation* (1993); and Boettke, *Calculation and Coordination* (2001).

path of organizational transformations that took place during the formative years of the Soviet system and the unintended consequences that follow from socialist aspirations confronting a refractory reality.

Rivalry and Central Planning, however, is not only an important book within comparative economic systems and the history of economic thought, but it is also a book about the key insights of the Austrian school of political economy regarding the nature of the competitive market process. As Lavoie demonstrates, it is through the debate that the Austrians clarified and deepened their understanding of the market process and it is in revisiting the debate that many of the distinctive features of the Austrian school can be gleaned. Specifically, it highlights the importance of the competitive market process in generating the knowledge that economic actors need to make rational assessments regarding which resources to use and which plans to pursue.

III

Although *Rivalry and Central Planning* is clearly Lavoie's most important and best-known contribution to Austrian economics, his contributions to the school extend well beyond this major work. Lavoie discovered Austrian economics in the 1970s. A computer science major at Worcester Polytechnic Institute who had only taken one class in economics to that point, Lavoie spent the summer between his junior and senior years working at the railroad. He was hired to operate the gate to let railcars pass by, but the gate had been automated a few years earlier. So Lavoie spent that summer at the tracks reading first Henry Hazlitt's *Economics in One Lesson*, then Hayek's *Road to Serfdom* and finally, Mises's *Human Action*. As he would say repeatedly in the years that followed, Lavoie was enthralled by Mises's ideas and loved Mises's magnum opus. After graduating Worcester Polytechnic in 1973, Lavoie attended the South Royalton, Vermont, Austrian economics conference organized by the Institute for Humane Studies alongside other key figures in the reemergence of the modern Austrian school. He then pursued graduate education in economics at New York University. At NYU, Lavoie wrote his dissertation (which would become *Rivalry and Central Planning*) under Israel Kirzner, a student of Ludwig von Mises, and was able to study under Ludwig Lachmann, a student of F. A. Hayek, as well as Fritz Machlup. After completing his degree

at NYU, Lavoie worked as a professor of economics at George Mason University until his death in 2001.

It was under Machlup's and Lachmann's influence, rather than Kirzner's, that Lavoie began to examine the philosophical underpinnings of the Austrian school as well as its implications for doing applied work within economics. Ironically, having settled the calculation debate between the Austrians and the market socialists, Lavoie is largely responsible for triggering the hermeneutics debate within Austrian economics. The hermeneutics debate largely turned on whether it was critical to stress the interpretive dimension of economics or if instead we should view economics as an objective science of subjective phenomena. The hermeneutics debate began in 1985 when George Mason University's Center for the Study of Market Processes released Don Lavoie's working paper "The Interpretive Dimension of Economics—Science, Hermeneutics, and Praxeology." Lavoie argued that Austrian economics' methodological propositions, especially its criticism of positivist economics, could be put on a more solid philosophical foundation if Austrians embraced the philosophical hermeneutics of Hans-Georg Gadamer. Gadamer had insisted that the meaning of a text or, in fact, any social phenomena, was at least partially dependent on the questions asked of and about it by the interpreter. As such, social science should not be seen as a quest for objective truth but as an interpretive exercise. Rather than welcoming this attempt to buttress the school's methodological underpinnings, the reaction to Lavoie's calls for an "interpretive turn" was overwhelmingly negative (see especially, Gordon 1986; Rothbard 1989; Albert 1988, 1989; Hoppe 1989; Perrin 2005). Rothbard (1989, 56), for instance, referred to Lavoie as "the spiritual head of [a] groupuscule" of "renegade Austrians and ex-Misesians gathered in the Center for Market Processes at George Mason University." For Rothbard, embracing hermeneutics meant rejecting economics.

This criticism seemed very odd coming from Rothbard of all people, who had written earlier on the importance of phenomenology in the Austrian methodological uniqueness among the sciences of human action. In many ways, what Lavoie and Richard Ebeling were doing in the 1980s was following up the footnotes from Mises in the 1930s and Rothbard in the 1960s and updating them by tracing the evolution of the philosophical arguments. Lavoie never advocated the "deconstructionist" postmodernism that he was accused of

promoting. Instead, he was pursuing the phenomenological hermeneutics that developed from mainstays in the Austrian economists lexicon of philosophical doctrine from Wilhelm Dilthey, Edmund Husserl, and Alfred Schütz. Mises was not an analytical philosopher, but a continental one, and his arguments for methodological dualism were grounded in continental philosophy and the focus on *verstehen*. Obviously, the methodological underpinnings of the social sciences and economics in particular had shifted since the 1960s, when Rothbard sought to defend the Austrian position against the methodological hegemony of formalism and positivism. The dominant scientific methodology had been the culprit in the confusion in the socialist calculation debate to begin with and in many ways, Lavoie understood that the unique analytical contributions of the Austrian school would continue to fall between the cracks unless the methodological debate was engaged. He believed that within the postpositivist philosophy of science the position that best situated the Austrian approach was to be found in phenomenological hermeneutics. Rather than abandoning economics, Lavoie was attempting to philosophically ground the contributions of the Austrian school in a language that modern methodologically minded social scientists could appreciate.

Rather than signaling the end of economics, the “interpretive turn” that Lavoie championed is responsible for an impressive wave of applied work within Austrian economics. Boettke (1990), for instance, has explored the Soviet underground economy and the role of informal rules in directing economic activity. Additionally, Boettke et al. (2005) have advanced a progressive research agenda that explores the political economy of cooperative arrangements that function without relying on the government (see also Stringham 2015). Likewise, Chamlee-Wright (1997, 2002, 2005) and Storr (2004, 2012) have written persuasively about the importance of culture in shaping economic actions and have done in-depth analysis of economic life in Africa and the West Indies utilizing ethnographic and archival approaches. Similarly, Leeson (2009) and Skarbek (2014) have undertaken compelling studies of the economic organization of criminal enterprises like pirate crews and prison gangs. Their studies used qualitative approaches to tease out the meanings that these criminal actors attach to their activities and alternatives, as well as to determine how the incentives that prospective and current pirate crew members and prison gang members face impact their behavior.

IV

Rivalry and Central Planning deserves to be read by future generations of scholars interested in the Austrian school not only because of its importance within the history of the school but also as an introduction to Don Lavoie's writings.

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