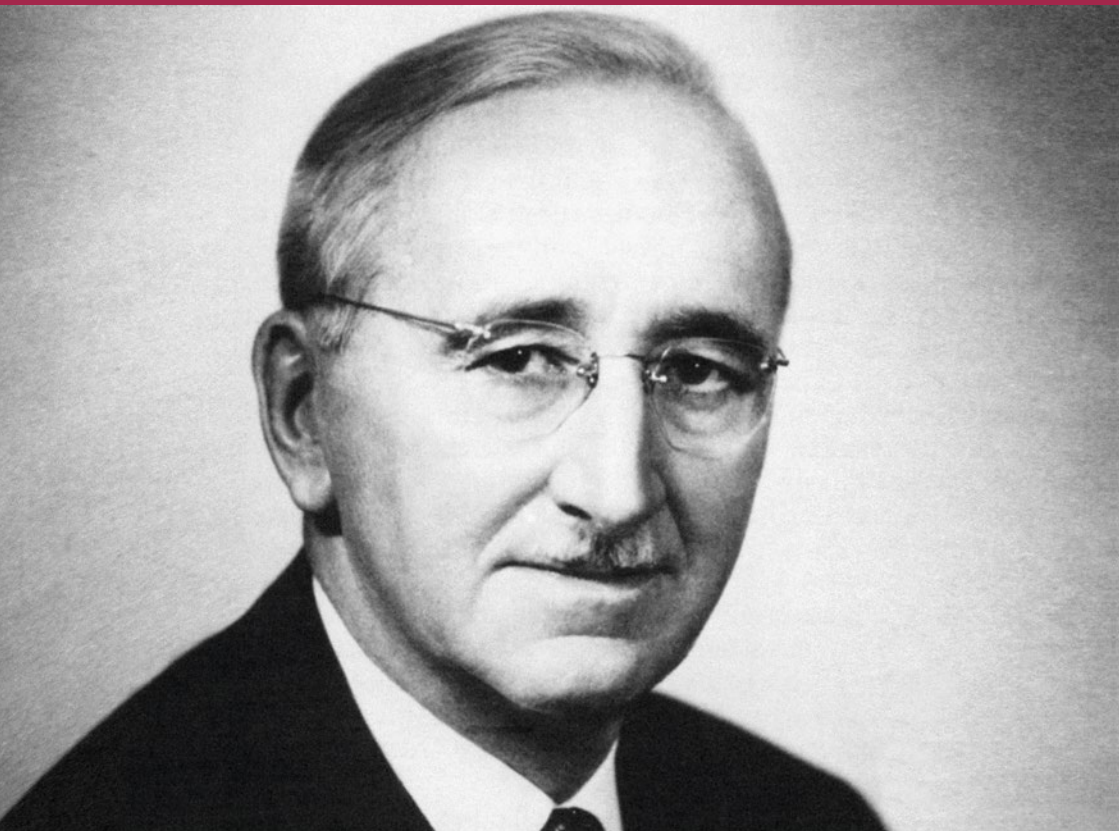


GREAT THINKERS IN ECONOMICS

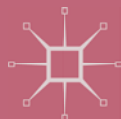
Series Editor: A.P.Thirlwall



F. A. HAYEK

Economics, Political Economy
and Social Philosophy

Peter J. Boettke



Great Thinkers in Economics

Series Editor
A.P. Thirlwall
School of Economics
University of Kent
Canterbury, UK

“An intellectual historian discussing an eminent figure in social theory must not only be sensitive to the subtle nuances of that theorist’s own contributions, he must be able to relate those nuances to the complex, shifting intellectual fashions against which that theorist was rebelling. Peter Boettke’s skillful treatment of Hayek’s intellectual journey brilliantly and provocatively succeeds in achieving this standard of excellence. This is a book that will be recognized as path-breakingly important for many decades to come.”

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—Bruce Caldwell, *Duke University, USA*

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Peter J. Boettke

F. A. Hayek

Economics, Political Economy and
Social Philosophy

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Peter J. Boettke
Department of Economics
George Mason University
Fairfax, VA, USA

F. A. Hayek Program for Advanced Study
in Philosophy, Politics and Economics
Mercatus Center, George Mason University
Fairfax, VA, USA

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Pictured left to right: Jack High, Don Lavoie, F. A. Hayek, John Egger, Karen Vaughn, Thomas DiLorenzo, and Richard Fink. At George Mason University in 1983

To Richard Fink, Karen Vaughn, and in memory of Donald Lavoie

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- Boettke, Peter. 1990. The Theory of Spontaneous Order and Cultural Evolution in the Social Theory of F. A. Hayek. *Cultural Dynamics* 3 (1): 1–11.
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Preface

It is a great honor to be asked to write a book on F. A. Hayek for the *Great Thinkers in Economics* series. For this opportunity, I owe my thanks to series editor Tony Thirlwall of the University of Kent. In his introduction to the general series, he writes: “The famous historian, E.H. Carr, once said that in order to understand history it is necessary to understand the historian writing it. The same could be said of economics. Famous economists often remark that specific episodes in their lives, or particular events that took place in their formative years, attracted them to economics. This new series, *Great Thinkers in Economics*, is designed to illuminate the economics of some of the great historical and contemporary economists by exploring the interaction between their lives and work, and the events surrounding them.” Hayek certainly lived an eventful life—one filled with up close witnessing of man’s inhumanity in World War I, the economic ruin of the Great Depression, and a dangerous game of brinkmanship with respect to Western civilization itself, with the rise of fascism and communism in the 1930s and 1940s; of meteoric professional success and crushing defeats that he often seemed to barely acknowledge as he continued on with the honing of his craft as an economist, political economist, and social philosopher; of personal relations torn asunder, as well as lasting and loyal intellectual and personal friendships. How all this impacts a thinker is for a historian to glean through devotion to archival work and placing thinkers and their ideas in proper context.

This book, however, is *not* a proper intellectual history. Part of this relates to the fact that as I embarked on this project, I did a survey of the intellectual landscape in what could be termed “Hayek studies.” A literal explosion in this field has taken place since 1975 and I document this in material in the appendices and in the “Living Bibliography of Works on Hayek” (<https://ppe.mercatus.org/essays/living-bibliography-works-hayek>) that provides bibliographic details on books, articles, dissertations, and citations. It is also the case that I have been working with, and writing on, Hayek’s ideas since the mid-1980s and have carved out a certain interpretative niche myself in this literature. So, the principle of comparative advantage kicked in as this project took shape the same way that it kicks in all our endeavors. As the epigraph to Philip Wicksteed’s brilliant *The Common-Sense of Political Economy* (1910) states, “we are all doing it, though none of us knows we are doing it.” Well, sometimes we economists are more conscious of when our behavior conforms to our theories than the average person. Still, it might make sense to first explain what not to expect from this book.

As already stated, it is *not* a proper intellectual history of Hayek—for that I recommend the works of Bruce Caldwell and in particular, not only his excellent *Hayek’s Challenge* (2004), but the various editorial introductions that Caldwell has written for the *The Collected Works of F. A. Hayek*, as well as his own ongoing research in a historical biography forthcoming on Hayek. Nor have I written a popular introduction to the essential ideas of Hayek for economic and social understanding, the best book for that in my judgment being my colleague and good friend Don Boudreaux’s *The Essential Hayek* (2015)—and the multimedia educational tools that go with it. Don is a master communicator of the basic principles of economics and he captures Hayek’s work on the price system and the political, legal, and social order in as readable and as concise a treatment as is humanly possible. My book is not an effort at attention grabbing among lay readers either—for that, we have Alan Ebenstein’s two works *Friedrich Hayek* (2001) and *Hayek’s Journey* (2003). I do not have the singularity of praise for Ebenstein’s work as I do for Caldwell and Boudreaux’s books, but I do recognize that there is much value to be found in his books; I just think there are some subtle issues in philosophy and technical economics that are ill-treated in such an effort at popularization. Writing to a general audience always has this risk associated with it, but those gaps in Ebenstein’s work have marred, for me, what I

otherwise would deem a valiant effort to communicate Hayek's ideas to a new audience and his relevance to a new time. Finally, my book, while dealing with the critical debates that Hayek engaged in throughout his long career of a methodological, analytical, and practical political economy nature, is *not* a proper history of economic controversy—for that, I simply point the reader to my colleague Lawrence H. White's *The Clash of Economic Ideas* (2012).

So, enough telling you what my book is not; let me tell you what it actually is, and how it fits into *The Great Thinkers in Economics* series. *The book seeks to clarify refinements in economics, political economy, and social philosophy that Hayek was led to make during his career because of the context of times and context of the argument.* In the process, it is my hope to clear up some general misconceptions about Hayek's ideas that have, in my humble opinion, served to block understanding the full implications of his arguments. While stressing the context—both historical and intellectual—the story I am weaving together will be one-sided and not one seeking balance between the contending perspectives. This is a story of the evolution of *a perspective* of economic, political economic, and social philosophic thought about how the world works. Hayek, in short, is given several bites of the apple in developing his argument in relationship to the central issues in economic theory, political economy, and social philosophy. The book that my book resembles the most would be Gerald O'Driscoll's *Economics as a Coordination Problem* (1977), but obviously, I have my own twist. That twist turns on what I term in this book *epistemic institutionalism*.¹ The various debates in which Hayek was embroiled during the 1930–1960 period led in economics and political economy to a renewed focus on the institutional framework, but primarily to the role that framework played in structuring the *incentives* that economic actors faced. While this *incentive institutionalism*, in the hands of Armen Alchian, James Buchanan, Ronald Coase, Harold Demsetz, Milton Friedman, Leonid Hurwicz, Douglass North, Mancur Olson, Vincent and Elinor Ostrom, Gordon Tullock, Oliver Williamson, and others played a significant role in forcing a major rethinking in economic science

¹ See this discussion at *Liberty Matters* initiated by my lead essay, “Hayek's Epistemic Liberalism” (September 2017) <http://oll.libertyfund.org/pages/lm-hayek>.

and political economy post-1950, and even though many of these thinkers stressed information and even some used the word “knowledge,” they do not fully address themselves to Hayek’s argument about the contextual nature of knowledge; the knowledge of time and place; the tacit domain of our knowledge, and therefore they do not (with the notable exception of the Ostros) address the discovery and learning aspect of alternative institutional arrangements as was the emphasis in Hayek.

If indeed the “curious task of economics is to demonstrate to men how little they really know about what they imagine they can design,” then the central question of economics becomes one about the institutional prerequisites required for learning and error correction among individuals in society (Hayek 1988, 76). It is Hayek’s deepening exploration of the *epistemic properties of alternative institutional arrangements* that is the primary focus of this book, and then, the drawing out of the implications of that focus for methodology of the social sciences, analytical economics, and practical public policy that I hope readers will see. I believe Hayek is of continuing relevance not because of the man Hayek, and not because of the critical role he played in intellectual debates during his career, but because of what his ideas still have to say to us in our context and in our debates to this day and where they may be going.

I think of Hayek’s intellectual journey as consisting of four phases, none of which are actually clearly distinct from one another. He begins his journey pursuing questions of a theoretical nature dealing with intertemporal coordination, and in particular, monetary and capital theory. Hog farmers, for example, are currently making investments in the maintenance of livestock that will only yield returns in the future. How is it possible that these farmers make this investment decision rationally?

Understanding how the assessment of the future demand for bacon guides the investment decisions in hog farming today is critical to answering the question of the coordination of economic activity through time. In developing his understanding of the “imputation problem,” Hayek emphasized the role that interest rates play in investment decisions, and the role that prices play in production decisions. He was working in the grand tradition of the first and second generation of Austrian School economists.

Hayek and his fellow Austrian economists were consciously articulating a particular branch of early neoclassical economics grounded in both subjective utility theory and the economic calculus of individual decision-making on the margin. But several things separated the Austrians from Carl Menger to Hayek from others in the neoclassical approach that would only become increasingly evident in the coming years: namely, a thoroughgoing subjectivism that would encompass not just value, but costs and expectations; incorporating the passage of real time in the analysis of exchange and production; the uncertainty of the economic environment and ignorance of the decision-maker must be acknowledged in the analysis of the choice calculus; the non-neutral nature of money so that distortions of the monetary unit can result in distortions in the patterns of exchange, production, and distribution; and the heterogeneous nature of capital goods that possess multiple specific uses. Steel, for example, can be used to build not only bridges and buildings, but steel is not all that critical in the production of ham sandwiches. Again, how do economic actors figure out the best way to extract iron ore, the best method to produce steel, the most valued use of that steel by others in the market, and in what amount and at what quality would best satisfy the uncertain and future demand for steel? The perennial economic questions of how, what, and for whom have to be answered and answered anew everyday by critical decision-makers scattered throughout the economy.

The *economic answer* provided by the Austrian School of economics placed prices at the center of the analysis of the economic system. Or, as we will see, they actually placed *property*, *prices*, and *profit-and-loss* in a position of prominence in their theoretical explanation of the coordination of economics activities. The production plans of some, to put this simply, must mesh with the consumption demands of others. Otherwise, scarce resources will be wastefully utilized and economic frustration among suppliers and demanders will result, and wealth-creating opportunities will be passed over. It is the function of property, prices, and profit-and-loss to structure incentives, mobilize information, discover and utilize the knowledge that is dispersed throughout the economy, and provide the spur for innovation and the feedback on bad decision-making that is necessary for economic actors to coordinate their plans, and in so

doing realize the mutual benefits of productive specialization and peaceful social cooperation.

This theoretical articulation of the continual process of the coordination of economic activity through time, and the adjustments and adaptations to changing circumstances guided by property, prices, and profit-and-loss can be found in the writings of Carl Menger, Eugen Bohm-Bawerk, Friedrich Wieser, Joseph Schumpeter, and Ludwig Mises, and we must always remember that this formed the common bases for the continued theoretical refinement of this analytical approach by Hayek and his generation of theoretical economists in Vienna: Fritz Machlup, Oskar Morgenstern, and Gottfried Haberler. This *market process theory* and *theory of the institutional framework* is the common core of the Austrian School of economics from its founding to today. And in my reading, Mises and Hayek were responsible for the greatest refinements of this contribution to scientific economics and the art of political economy.

I have belabored this first phase of Hayek's career because it is from this common core that all the other phases of his career emerge. This first phase can be termed, for our purposes, **Economics as a Coordination Problem** and can be roughly dated 1920–1945. It is in this phase that Hayek makes many, if not all, of his most original contributions to economic science. As Hayek developed these various contributions, he first encountered acceptance by other leading economists, for example, his appointment at the London School of Economics in the early 1930s. However, as the decade of the 1930s progressed, his ideas met with greater resistance. This resistance came in the form of both a philosophical rejection of his approach and an analytical rejection of his theory of the market process and the theory of the institutional framework.

Hayek's brilliance, I contend, was to see the philosophical and analytical rejection as interrelated. This led naturally to the second phase of his career, which was labeled by him as **The Abuse of Reason Project**, which I date as running between 1940 and 1960. In my reading, the culmination of this project was not only Hayek's *The Counter-Revolution of Science* (1952), but *The Constitution of Liberty* (1960) and his critique of the rational constructivism of the administrative state. Viewed in this way,

Hayek's third phase of his career also seems to follow naturally from the previous two.

In the period between 1960 and 1980, Hayek transitioned to a third phase of intellectual inquiry, **The Restatement of the Liberal Principles of Justice**. Here, Hayek articulates the importance of general rules—a theme of course that a careful reading of *The Road to Serfdom* (1944) would also reveal as key to his analysis of the institutional framework. As Hayek developed these ideas in more depth, he sharpened his critique of the modern theory and practice of democratic society. Crucial to Hayek's work during this period is the contrast between the liberal principles of justice and the demands of social justice.

The interconnection between Hayek's first three phases of his career is reflected throughout his work, and as I said, as a matter of historical record, it is near impossible to draw distinct boundaries around the different phases. He was always working as a technical economist concerned with the problem of economic coordination through time, and he was always a political economist who cared about the institutional infrastructure within which economic activity took place. And he was always a social philosopher who thought seriously about the liberal order. As Erwin Dekker (2014) has recently argued, we must understand the contributions of Hayek, and his fellow Austrian School economists, as the product of “students of civilization.” This was always the subtext even in the most technical of discussions about money, capital, interest, and the price system. And this discussion animated the seminars and discussion groups that made up the various intellectual circles in interwar Vienna. And it was this discussion that animated Hayek's later efforts with the Mont Pelerin Society. As Hayek (1967, 123) argued in his essay “The Dilemma of Specialization,” the social sciences are in a different position than the natural sciences. “The physicist who is only a physicist can still be a first-class physicist and a most valuable member of society. But nobody can be a great economist who is only an economist—and I am even tempted to add that the economist who is only an economist is likely to become a nuisance if not a positive danger.”

Post-1980, Hayek's work turned to what I would term **Philosophical Anthropology and the Study of Man**, the last phase of his intellectual journey, ending with his death in 1992. The culmination of this phase in

his career was *The Fatal Conceit* (1988). His work during this time is a challenge not only to the development in economic thinking by John Maynard Keynes and Oskar Lange, but broad social theorists such as Karl Marx, Sigmund Freud, and Karl Polanyi. The arguments that Hayek develops in this phase of his career will not be treated with the depth they deserve in this book. It is my hope that future scholars will find the ideas I discuss in these pages to be intellectually enticing and promising so they will want to apply them to the contemporary intellectual debate in moral economy and social economy.

In what follows, we will mainly focus on the intellectual evolution of the first three phases in Hayek's career, and try to highlight as I have said is my purpose—the refinement and articulation of Hayek's *epistemic institutionalism*. It is important for my narrative to understand that Hayek never abandoned the first phase of his journey. From 1920 to 1980, his work consistently and persistently is grounded in his “Austrian” understanding of the coordination of economic activity through time. But he was compelled to explore the underlying philosophical reasons why his fellow economists were resistant to his analysis of the coordination problem. As he said on various occasions, figuring out why others did not find conclusions he thought logically followed from the economic calculus and market theory was of utmost importance to him, and a great stimulus for his work. Why did economists in the 1930s–1960s seem to overlook not only the insights of the Austrian economists from Menger to Mises, but the teachings of the classical political economists such as David Hume and Adam Smith? Why did they overlook the institutional framework that the classical and early neoclassical theorists had taken as given? What happened to the basic understanding that economists and political economists shared concerning property, prices, and profit-and-loss? And since he believed he put his finger on the philosophical culprit, how can we restate the foundations of our scientific discipline and discuss the political economy of a free people once we overcome this intellectual detour?

The structure of the book will follow this chronological and intellectual order I have just presented. After a chapter identifying what I think are the greatest misconceptions about Hayek in the secondary literature, and a brief biographical chapter, I proceed with a chapter addressing

money, capital, and business cycles, followed by a chapter on market theory and the price system. I then turn to Hayek's battle with socialism in two chapters, and then turn to his development of a genuine institutional economics. The ideas Hayek developed through his first two phases of his career—1920–1960—culminate in his version of institutional economics, but I would argue that his institutional economics must be read back in an explicit way into his earlier writings to truly understand Hayek's scientific contributions and the revolutionary implications for the practice of the science of economics and the art of political economy.

Just as Hayek, after his battle with Keynes and macroeconomics, and his battle with market socialists and *The Road to Serfdom*, turned his attention (at least in part) to the rejuvenation of the liberal project, so do I turn to this project. I do not provide a full history of the Mont Pelerin Society (MPS), but it is obvious that MPS played a major role in Hayek's career and life. But MPS, to Hayek, I would argue, was understood as a scholarly project and not an ideological or public policy project as it is often portrayed by skeptics of MPS and the liberal project. I would contend that MPS is a debate and discussion society headlined by Hayek, Milton Friedman, and James Buchanan. Of course, the society can also boast as members several other Nobel Prize economists, such as George Stigler, Gary Becker, and Vernon Smith, but I think in painting with a broad brush describing the society's intellectual culture with reference to Hayek, Friedman, and Buchanan is quite accurate. MPS was never a Davos for neoliberal economists as critics have continually sought to depict it as, but has always been a debate and discussion society concerned with foundational issues facing the liberal society. And this was actually the purpose starting actually with the Walter Lippmann Colloquium in 1938, which would inspire Hayek to found MPS in 1947. The rejuvenation of liberalism in Hayek's time and in our time is the subject of Chaps. 8, 9, and 10.

The book concludes with a discussion of what I view as the progressive research program in the social sciences and humanities of Hayek's legacy. Here again, I hope the reader will find insight and inspiration on how to think seriously about fundamental issues in economic science, political economy, and social philosophy.

In working on this book, I benefited greatly from the financial support from the Earhart Foundation and the John Templeton Foundation, as well as the general academic support from the Mercatus Center and the Department of Economics at George Mason University. Through this support, I was able to make research trips to the archives at the Hoover Institution on War, Revolution and Peace, where Hayek's papers are located; the London School of Economics, where Lionel Robbins's papers are located; Grove City College, where Mises's papers are located; the Library of Congress and Abba Lerner's papers; the University of Vienna, and the ongoing work in establishing the collection of papers of James M. Buchanan at George Mason University. Numerous people helped me with this background research and I want to especially thank Rosemary Boettke, Emily Skarbek, and Roland Fritz. I have relied on several research collaborators throughout my years of writing on Hayek; these include: Paul Aligica, William Butos, Rosolino Candela, Christopher Coyne, Daniel D'Amico, Steve Horwitz, Roger Koppl, Peter Leeson, Jayme Lemke, Adam Martin, Kyle O'Donnell, Liya Palagashvili, Ennio Piano, David Prychitko, Emily Skarbek, Dan Smith, Nicholas Snow, Virgil Storr, Vlad Tarko, and Karen Vaughn. Thank you to all of them for how much I have learned in the process of working with them to try to make sense of Hayek's ideas and their evolutionary potential. As this project took shape, I also benefited from the critical feedback and suggestions from Solomon Stein—a talented intellectual historian of economic ideas, who happens to love archival research and the contextualization of ideas, so he was a great sounding board as this project was working through the various steps along the way. I also need to express a great intellectual debt to Rosolino Candela—a very talented economist who cares passionately about ideas and has been a constant source of inspiration and assistance throughout. I also benefited greatly from a faculty lunch organized by my colleague Jayme Lemke where I got critical feedback on the project from my colleagues at the F. A. Hayek Program for Advanced Study in Philosophy, Politics and Economics: Paul Aligica, Don Boudreaux, Tyler Cowen, Chris Coyne, Stefanie Haeffele, Roberta Hertzberg, Peter Leeson, Virgil Storr, Richard Wagner, and Lawrence White. Throughout the project, I was helped in a variety of ways by a team of graduate students: Caleb Fuller, Aidan Harkin, Ennio Piano, Scott King, Andrew Humphries, Kaitlyn Woltz, Bryan Cutsinger, Nathan Goodman, John

Kroencke, and Jordan Lofthouse. And none of this would be possible without the constant intellectual and administrative support I received from Eric Celler and Stephen Zimmer. I also would be very remiss if I did not acknowledge the great assistance I have received through the years in building our research and educational program here at GMU and Mercatus from Peter Lipsey. To say his contributions have been indispensable would be an understatement for they have been the very meaning of the term “mission critical”. I cannot thank him enough for what he has helped me do here at GMU/Mercatus. I must also thank Tyler Cowen, Brian Hooks, and Dan Rothschild for their leadership at the Mercatus Center and for their general support of our research and graduate educational programs at GMU. Finally, as this manuscript was going through the final edits, I benefited greatly from comments from Tony Thirlwall, Chris Coyne, Rosolino Candela, and the excellent editorial suggestions of my colleagues at Mercatus McKenzie Robey and Erica T Celler, as well as both Clara Heathcock and Laura Pacey at Palgrave Macmillan. I would also like to thank Production Project Manager Dhanalakshmi Jayavel for her attention to detail in guiding this project through its final stages. Of course, the usual caveat holds.

Much of the story that you will encounter here has appeared in one form or another through the years, starting with my first published papers in the 1980s. During that course of time, of course I have accumulated a great debt to such scholarly mentors as James Buchanan, Warren Samuels, Israel Kirzner, and Mario Rizzo, and a list of fantastic PhD students whom I have had the privilege to work with so closely in developing my ideas at both NYU and GMU. Chris Coyne, Peter Leeson, and Virgil Storr were once students of mine in name, but in reality, they have always been my closest collaborators, cherished friends, and professional colleagues, who I am lucky enough to work with at GMU to build our research and educational programs. But my biggest debt actually goes to the individuals directly responsible for my professional career in economics and how they shaped that—Richard Fink, Don Lavoie, and Karen Vaughn. In the 1980s, they established the Center for the Study of Market Processes at George Mason University, and along with the Center for Study of Public Choice formed the core of a new PhD program in economics. I was in one of the first classes of PhD students in that program beginning in 1984 and finishing in 1988. They created the

intellectual space in academia where the ideas of Hayek were treated neither as sacred texts to be memorized with great care and uncritical acceptance, nor as a closed chapter in the history of economic thought. Instead, they insisted that we treat Hayek's texts as an invitation to inquiry into the yet unwritten chapters of a progressive research program in the social sciences and humanities. That vision still inspires me today, and the institutional infrastructure that Rich, Don, and Karen created at George Mason University has made possible our efforts to translate that earlier inspiration to an aspiration to ultimately a realization in our research and graduate education initiatives at the F. A. Hayek Program for Advanced Study in Philosophy, Politics and Economics at the Mercatus Center at George Mason University. It is with that acknowledgment in mind that I dedicate this book to Richard Fink and Karen Vaughn, and in the memory of Don Lavoie.

Department of Economics

Peter J. Boettke

George Mason University

Fairfax, VA, USA

F. A. Hayek Program for Advanced Study

in Philosophy, Politics and Economics

Mercatus Center, George Mason University

Fairfax, VA, USA

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Clarifying Some Misconceptions About Hayek

F. A. Hayek is a lightning-rod figure in the social and policy sciences. He is often criticized, along with Milton Friedman, as the architect of a neo-liberal conspiracy that somehow hijacked the twentieth century and created tensions and conflicts that plague the twenty-first century. I will not be able to fix those interpretative issues in this book. If you are expecting an effort to counter Naomi Klein or Corey Robin and their attempt to scandalize Hayek and his project, this book is not where to look. There are two reasons for this. First, I believe the writings of Naomi Klein and Corey Robin are actually not that challenging to a serious student of Hayek's work; they are, instead, musings of ideological ax-grinders who appeal to those who already believe as they do. I would like to avoid that entire "intellectual" enterprise.¹ If you want to read legitimate scholarship that finds serious flaws in Hayek's writings and actions in this area of the scandalous, I recommend, instead, the works of Andrew Farrant and Edward McPhail (2014). For a more empathetic discussion of Hayek, I

¹ See my 2017 Liggio Lecture "Context, Continuity and Truth," <https://www.atlasnetwork.org/news/article/context-continuity-and-truth-theory-history-and-political-economy> for a discussion of what I believe to be the intellectual bankruptcy of the "hermeneutics of suspicion" in the history of ideas, and how this is a problem for both the left and the right. Science and scholarship, I would contend, advance in a culture of criticism, not as often portrayed in a culture of skepticism for this very reason.

would recommend Bruce Caldwell and Leonidas Montes (2015). Second, my purpose throughout this book is not to defend Hayek the man, but to discuss the evolution of Hayekian ideas. In this regard, I believe an extended discussion about Hayek, his efforts with the Mont Pelerin Society, and his purported relationship with political figures such as Pinochet, Reagan, or Thatcher is simply tangential to my purposes except as it relates to the focus on the evolution of Hayekian ideas.

F. A. Hayek, like all of us, was a flawed man. He was, in a strange way, thrust into public view early in his career, then again in the middle of the career, and finally, at the end of his career—with long lapses of general disinterest in what he had to say by the intellectual elite and general public. He fought with John Maynard Keynes, he fought with a variety of socialists such as Oskar Lange, and he fought in general with an intellectual *zeitgeist* that he struggled to fully grasp. Hayek, the man, demonstrated the same confusions and frustrations in trying to make sense of it all that all flesh-and-blood human beings do, and in the process, said and did things, I am sure, in hindsight he would regret.

No doubt some of the remarks he said about the situation in Thatcher's England or Pinochet's Chile would qualify as such remarks. But his relationships with those in political power was remote at best as Hayek was *never* a political consultant to any leader in power; he was always a critical scholar who tried to speak truth to power from the outside. While I have no desire to defend Hayek, the man, I still have to ask—as Michel Foucault in *Power/Knowledge* (1980, 135) taught—what in those texts of Hayek that supposedly were developing an argument for true liberalism might make possible authoritarian regimes?² Hopefully, the reader will find my exposition of Hayekian liberalism in the later parts of this book

² See along these lines not only Farrant and McPhail's (2014) discussion of "transitional dictatorship," but Meadowcroft and Ruger (2014) and the discussion of the relationship between liberty and democracy in the works of Friedman, Hayek, and Buchanan. In these discussions, however, we must always keep in mind that there exists an "institutional possibility frontier" that any historically situated society also must take as a given constraint in time that consists of the existing stock of human capital and technology. There are, in essence, constraints on the constraints of our choosing. This makes for some very complicated issues in the historical examination of pathways to political and economic development. See Boettke et al. (2005) and the references therein, but also the work by North et al. (2009) and Acemoglu and Robinson (2004). As my colleague Pete Leeson likes to say, the rules in any given society might tell us what is permissible, but the constraints tell us what is possible.

as a sufficient beginning to this necessary conversation on the nature and significance of the liberal project for our times.

Hayek, the man, witnessed first-hand the inhumanity of World War I (WWI) and was dismayed by the lack of understanding among his London School of Economics (LSE) colleagues of the developments in Germany during the 1930s (see Hayek [1963] 1995, 62). Thus, his overarching concerns were the institutional setting of economic life and how that institutional setting could be destroyed by unrestrained government (whether democratic or not). Hayek's articulation of Hayekian liberalism was incomplete, and thus, the Hayekian argument needs to be continually worked on so as to realize a better understanding of the institutional infrastructure of a political order of a free people: a political order that exhibits neither discrimination nor dominion. Hayek was in many ways a revolutionary, but strictly in the intellectual sense and not in the political sense.

Unfortunately, Hayek suffered the fate of an intellectual revolutionary in two ways. He was misunderstood by foes and falsely appropriated by friends as a result of the intellectual prejudices of the times. In the practical policy realm, this meant that his books such as *The Road to Serfdom* ([1944] 2007)³ and *The Constitution of Liberty* (1960) were not read, but displayed. His arguments were not wrestled with, but reduced to slogans. In the realms of methodology and analytics, Hayek's bold ideas were either incorrectly translated into the preferred language of the day—the very language he was trying to get folks to break out of—or they were outright dismissed as either incomprehensible or relics of an earlier age that science had progressed beyond. I recently wrote in an article for the *Journal of the History of Economic Thought* that: “Mises was a sophisticated nineteenth-century thinker and Hayek was a sophisticated twenty-first-century thinker, but in both instances the twentieth century didn't know how to deal with their arguments about methodology, analytic methods, and the political economy import of their analysis of socialism, interventionism, and radical liberalism” (2015, 84). This thesis will be repeatedly

³ Keynes famously commented on Hayek's *The Road to Serfdom* in a letter dated June 28, 1944, reprinted in John Maynard Keynes, *Activities 1940–1946: Shaping the Post-War World: Employment and Commodities, The Collected Writings of John Maynard Keynes* Vol. 27 (1980, 385).

stressed as we study the evolution of Hayekian ideas concerning *epistemic institutionalism* and attempt to clarify a variety of misconceptions about Hayek's argument along the way.

So, putting aside the ideological misconceptions that are embedded in the critique of neoliberalism, the main scientific misconceptions are:

1. Hayek's methodological individualism was based upon atomistic actors who were *perfectly rational*.
2. Hayek saw the price system as *perfectly efficient*.
3. Hayek was *categorically opposed* to government action.
4. Hayek presented a *slippery slope argument* toward totalitarianism in *The Road to Serfdom*.
5. Hayek saw something being the product of spontaneous order as a *normative approval* of that order.
6. Hayek's resistance to formal modeling and statistical testing was based on old-fashioned methodological ideas that led to *dogmatic stances* rather than scientific progress.
7. Hayek's evolutionary arguments developed late in his career about group selection constituted an *abandonment* of his earlier *methodological individualism*.
8. Hayek's ideas on monetary theory and the price system *never evolved* throughout his career.
9. Hayek's ideas were *roundly defeated* by Keynes with respect to macroeconomics, and by Lange-Lerner with respect to the market socialism.
10. Hayek effectively *abandoned economics* after the publication of *The Pure Theory of Capital* ([1941] 2007) and retreated to political theory, legal theory, and public intellectual work.

It is my hope to counter each of these ten claims throughout this book. I will make judicious use of quotes from Hayek's body of work, which challenge each of these claims so the reader can see that these misconceptions are a product of efforts to pigeonhole a thinker who defies easy characterization. They are not, however, *the* topic of focus in the chapters to come, but they will all be challenged in the material I present. It is my sincere intent to demonstrate that Hayek's ideas went through critical

refinement throughout his long career, and that there is a fundamental coherence in those refinements in his capacity as an economic theorist, a practitioner of political economy, and as a social philosopher.

Hayek did not shift topics and fields to run away from perceived intellectual defeats. Rather, he sought to deepen our understanding of the nature of the economic problem that modern societies must confront and the demands of a truly liberal order. He became an economist in his late teens and early 20s and he remained an economist into his 90s, but in order to appropriately place his intellectual innovations in economics, he had to situate those ideas in various intellectual and institutional contexts—not unlike the Scottish Enlightenment Philosophers who he took so much inspiration from: David Hume and Adam Smith. His technical economics bumped into his political economy, and his political economy bumped into his yet broader social philosophy, but that social philosophy also feeds back into a deeper understanding of his technical economics. As Hayek himself has put it, “the task of economic theory was to explain how an overall order of economic activity was achieved which utilized a large amount of knowledge which was not concentrated in any one mind but existed only as the separate knowledge of thousands or millions of different individuals,” but “only through a re-examination of the age-old concept of freedom under the law, the basic conception of traditional liberalism, and of the problems of the philosophy of the law which this raises, that I have reached what now seems to be a tolerably clear picture of the nature of the spontaneous order of which liberal economists have so long been talking” (1967: 91–92).

Karen Vaughn (1999) once published a paper on “Hayek’s Implicit Economics,” where she tries to articulate the underlying economics that can be found in his later writings. This book is completely consistent with that spirit. Moreover, it also asks the reader to think seriously about “Hayek’s Implicit Political Economy and Social Philosophy” that provided the institutional background even as he developed his most technical economics in the 1920s and 1930s. By weaving back and forth between the implicit background and the explicit foreground of analysis in Hayek’s career as divided from the 1920s to the 1940s, and then from the 1950s to 1980s, what is implicit in both will become explicit and thus capable of serving as building blocks for something altogether new

in the twenty-first-century practice of economics, political economy, and social philosophy.⁴

As a matter of historical fact, the critical period for the development of Hayekian ideas is from 1930 to 1950, though there was continuous development after 1950, and foundational developments in the 1920s.⁵ But for the period I see as critical, one must always remember Lionel Robbins's (1971, 129) warning that "the historian of the future, if he wishes to treat of the relations between London and Cambridge during this period ... that any generalizations that he may wish to make must fit facts of considerable complexity if they are not seriously to misrepresent the situation." Indeed, the disputes of these times that sharpened Hayek's thinking were complex. They took place during economic crisis in the UK and the USA, and political crisis in Germany and elsewhere in Continental Europe, and would eventually result in World War II (WWII). These disputes, in other words, were more than just purely academic exercises.

To put things in historical context, it is useful to look at a few charts and figures that might give us a window into the everyday world that an economic and social thinker confronted during Hayek's formative years as a researcher of consequence. The changes during Hayek's life are nothing short of monumental. Figure 1.1 illustrates the 20-year period of unemployment rates in Germany, the UK, and the USA, each of which was unable to escape the macroeconomic consequences of the Great Depression, and address the economic situation that was the historical background against which Hayek developed his economic ideas. Figure 1.2 is meant to illustrate roughly the standard of living in the countries where Hayek was working throughout his career—Austria

⁴On the analytical importance of thinking about background and foreground and how shifting those results in radical shifts in perspective, see Richard Wagner's brilliant *Mind, Society and Human Action* (2010, 1–26) and his idea of bivalent logic for economic inquiry.

⁵"When I look back to the early 1930s, they appear to me much the most exciting period in the development of economic theory during this century." It was, Hayek continues, "a high point and the end of one period in the history of economic theory and the beginning of a new very different one." He is referring there to ascendancy of Keynesian macroeconomics that treated "the economic process in terms of aggregates" rather than focus on the "structure of relative prices," and thus was unable to provide an explanation of "changes in relative prices or their effects." This would require, Hayek suggests, economists to someday go back to the 1930s and "take up where we left off then" to make progress in economic theory once again ([1963] 1995, 49; 60; 49).

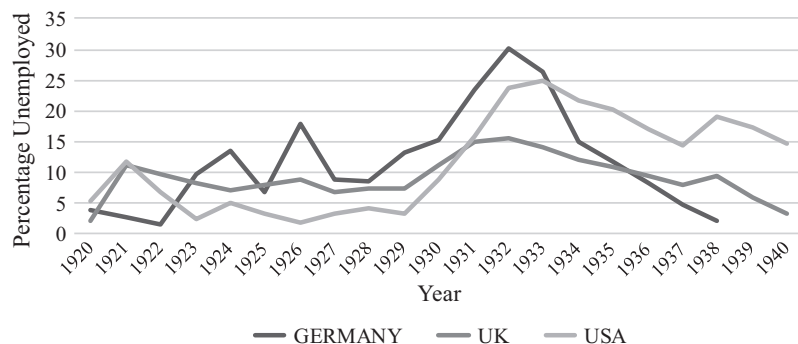


Fig. 1.1 Unemployment rate in Germany, UK, and USA, 1920–1940. Source for UK and Germany: Mitchell (1998a). Source for USA: Mitchell (1998b)

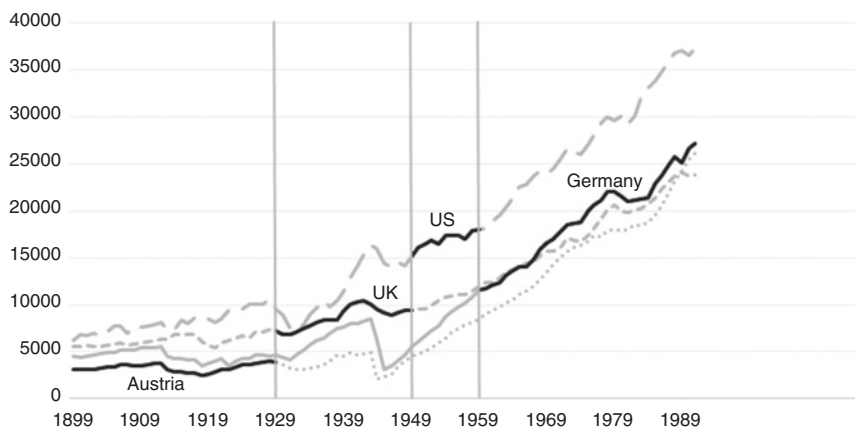


Fig. 1.2 Real GDP per capita. (Source: Bolt et al. (2018))

(1920), the UK (1930s–1940s), the USA (1950s), and Germany (1960s–1980s). In the same countries and during the same period Fig. 1.3 illustrates the growth of government as a percentage of Gross Domestic Product (GDP) due to the rise of the welfare state, particularly after WWII. And, it is critical to always keep in mind, as illustrated in Fig. 1.4, the experienced inhumanity that thinkers of this time were forced to process during the first half of the twentieth century. To capture this, look at the death toll from WWI, Soviet Communism, Nazi Germany, and WWII.

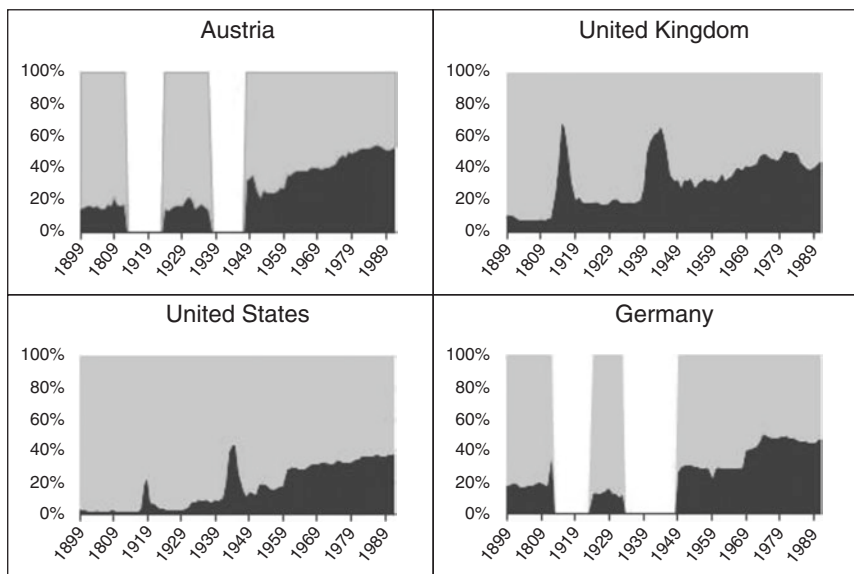


Fig. 1.3 Government expenditure as a % of GDP. (Source: IMF (2016))

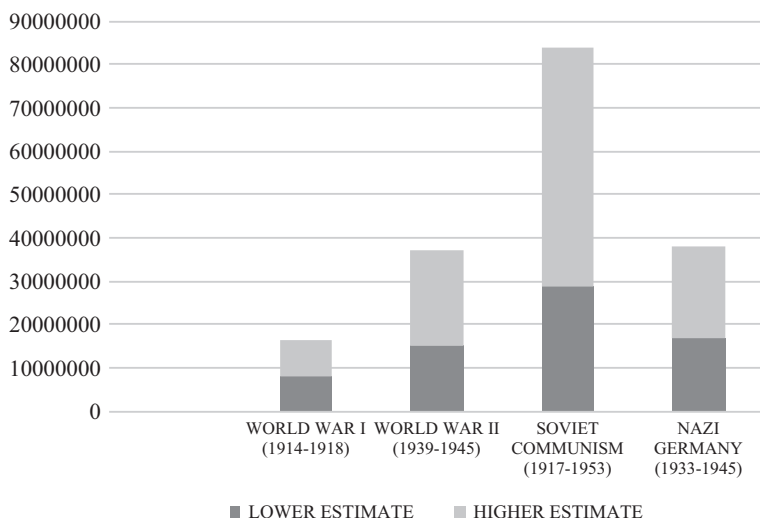


Fig. 1.4 Number of deaths. Sources: WWI lower estimate (Source: Haythornthwaite (1992)). WWI higher estimate (Source: White (2011)). WWII lower estimate (Combat deaths) (Source: Rummel (1994a)). WWII Higher estimate (Combat deaths) (Source: White (2011)). Communist Russia lower estimate (Source: White (2011)). Communist Russia higher estimate (Source: Rummel (1994b)). Nazi Germany lower estimate (Source: White (2011)). Nazi Germany higher estimate (Source: Rummel (1994c))

It is against this historical backdrop of economic and political turmoil that social science was being developed in the 1930s and 1940s. These grand debates in economics and political economy were taking place to understand the prior causes that resulted in the macroeconomic instability of the Great Depression, the problems and difficulties of socialist planning, and the future of a humane and civil social order. As Hayek wrote to his good friend Fritz Machlup in June 21, 1940, the work he was doing on *The Abuse and Decline of Reason* constituted a very important challenge to the prevailing wisdom of the day and was, in his judgment “the best I can do for the future of mankind.”⁶ The disputes were not merely abstract academic discussions, but addressed the bridging of the gap between high theory and practical policy in a very fundamental sense. The cutting edge of academic research was meant to address the pressing needs of public policy, since the stakes were to be found in Western civilization itself. The disputes were fundamental, but they were also personal and cut very close to the bone.

To give an example of the sort of impression one gets from commentators even as skilled as Robert Skidelsky, consider this summary judgment that Hayek did not engage Keynes after *The General Theory* (1936) was published because “Hayek did not want to expose himself to another mauling from the Keynesians,” and that as a result, he became by the late 1930s a “bystander as the Keynesian Revolution unfolded” (1992, 456–459). Even Hayek’s closest associate at the LSE, Lionel Robbins, recanted his intellectual affinity to the Austrian school and argued that his trouble was purely intellectual. He “had become the slave of theoretical constructions which, if not intrinsically invalid as regards logical consistency, were inappropriate to the total situation which had then developed and which therefore misled my judgment” (1971, 153). Robbins would put his change of mind in a very dramatic form, arguing that:

Now I still think that there is much in this theory as an explanation of a *possible* generation of boom and crisis. But, as an explanation of what was going on in the early '30s, I now think it was misleading. Whatever the

⁶This letter can be found in the Fritz Machlup papers at the Hoover Institution Box 43, Folder 15 and is reprinted in Volume 13 of Hayek’s *Collected Works* (2010, 312–313).