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F.A. Hayek and the Modern Economy: Economic Organization and Activity

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Introduction

SANDRA J. PEART AND DAVID M. LEVY

In April 2013, the University of Richmond's Jepson School of Leadership Studies hosted a conference on Friedrich A. Hayek to examine his thought in the context of social, philosophical, and economic concerns that have become more pressing over the past five years. We note at the outset the following perhaps idiosyncratic set of reasons for why it is appropriate to consider Hayek in the context of leadership and statesmanship in 2013.

First, in 2006—so, notably, well before the financial crisis—we were invited to the Italian economists' conference in Lecce, Italy,¹ and Sandra Peart gave the plenary talk. As she was at that point beginning a project for the general editor of the Hayek works, Bruce Caldwell, a republication of Hayek's 1951 book, *John Stuart Mill and Harriet Taylor: Their Friendship and Subsequent Marriage*,² she wrote a talk provocatively entitled "Did Mill Ruin Classical Liberalism?"³ The audience and discussion were lively. But the most telling comment came from her then eight-year-old son, Matthew, who listened to the session and, at the end, proclaimed that Mill was wrong and Hayek was right. This was an early wake-up call—to redouble our efforts to appreciate Hayek!

Then, more than four years ago, Russ Roberts stopped us at the Allied Social Sciences Association annual conference in January and showed us—hot off the presses—the now famous first Keynes–Hayek rap video.⁴ In April 2013, that video had obtained about 4.2 million views. In 2012, Peart designed and taught a course at the Jepson School of Leadership Studies entitled Economic Policy and Leadership using the Keynes–Hayek debates as the backdrop. One student in the class reported that while he was watching the video in the library a female

student approached him and asked what he was watching. He reportedly replied “Only the coolest rap video ever made!” In 2009, Peart spent a week at Duke University lecturing for a National Endowment for the Humanities program alongside Bruce Caldwell. Caldwell’s republication of Hayek’s 1944 *The Road to Serfdom*⁵—the original of which our Jepson School colleague Gary McDowell reminded us earlier this spring influenced the late Margaret Thatcher⁶—reached number one on Amazon that week. For a scholarly publication to achieve such heights suggests the economics of F. A. Hayek warrants renewed and vigorous attention.

Taken together, the foregoing is evidence of a renaissance of interest in Hayek scholarship. Importantly, this has included a reexamination from the left as well as the right: Hayek’s challenge to socialism has recently been explored by market socialists such as Theodore Burczak.⁷ Our hope for this book is that it will further our understanding of Hayek as a leader in the dimension of ideas and in policy space. Many know of the Nobel laureate’s influence through his *Constitution of Liberty* or *Law, Legislation and Liberty*. Experimental economists and psychologists have explored insights from both his thoughts on the “division of knowledge” culminating in the 1945 “Use of Knowledge in Society”—about which Václav Klaus writes so dramatically later—and *The Sensory Order*. The chapters included in this book examine the foundational influences on Hayek, his insights for economic, political, and social organization and activity, and his legacy in terms of policy making. We benefited greatly from the lively discussions in April, discussion that not surprisingly yielded common themes across essays.

Perhaps most importantly, this book focuses on Hayek’s views on the role of human agency. As an economic and political theorist first and foremost, Hayek explored this question in two ways. First, what role does any one individual have in determining one’s economic and social well-being? Kenneth Minogue’s contribution explores Hayek’s trenchant views on the conditions of individual freedom. Perhaps not surprisingly, however, Minogue quickly turns up the collectivity, what Minogue views as Hayek’s denial of the plausibility of socialism on factual and logical grounds. Peter McNamara points out that, notwithstanding his great admiration for Adam Smith, Hayek does not emphasize the sympathetic process that Smith elaborates in his *Theory of Moral Sentiments*.

So, second, the question arises as to how we make decisions when we are connected, as Hayek emphasized, to others in groups of varying importance to the self, groups that range from the tight-knit family to

the polity and the extended order of the marketplace. From this follows the additional question of what agency policy makers, those who might be thought of as leaders, possess in determining overall well-being of those in the polity. This is the focal point for Minogue and also for Bruce Caldwell, in the preface to this volume. The question ultimately leads to a consideration of Hayek's views as they relate to socialism and to planning. As is well known, Hayek maintained that prices and outcomes that emerge from the marketplace convey important information to producers and consumers, information that no one central planner (leader) can obtain. Consequently, he argued that planning invariably leads to the imposition of the desires and best guesses of the planners upon the rest of the group, the polity.

This book explores the question of agency, first from a foundational level, as a number of authors—McNamara, Sandra Peart, and David Levy—examine Hayek's relationship to liberalism of the nineteenth century and more recent sort. Hayek drew a line between the work of Scottish moral philosophers such as Adam Smith and the later work of those "false" individualists, including John Stuart Mill. Peart, Levy, and McNamara consider whether that line is well placed and, perhaps more importantly, whether and how the distinction between true and false individualism informs the analysis of economic policy today.

Peart and Levy demonstrate how Hayek distanced himself from a second sort of (self-identified) "individualist," in the mid-twentieth century. Hayek, prompted by the Mont Pèlerin Society elders such as Knight's follower, James Buchanan, even allowed his manuscript to be given over for editing. More than this, he distanced himself from the individualists such as William F. Buckley Jr., at a time when these intellectuals enjoyed enormous influence as public intellectuals.

We attempt in what follows thus also to situate Hayek's writing as it relates to economic organization and activity, in particular to assess what role Hayek assigns to leaders in creating and sustaining economic progress. We ask, what is the scope for policy makers to lead the economy through crises and the inevitable ups and downs that accompany economic expansion? How much agency should policy makers assume and when are unusual mechanisms called for? Second, what leadership role do economists legitimately play in the development and implementation of new economic policy? Hayek held that economists should take center stage in terms of advocating economic policy but his was a quite different sort of advocacy. He disagreed with some of his contemporaries on what economic policies were best suited to promote economic expansion and stability. The book explores the nature of these disagreements.

An overriding theme in what follows is Hayek's challenge concerning knowledge and the difficulty of accumulating information about aggregates of the economic system. For Hayek, economic aggregation is fraught with methodological difficulties and hence no scientist or policy maker has the wherewithal to direct market transactions. The contributions by Bruce Caldwell and Emily Skarbek examine these questions. Gerald Gaus explores the related question of rules versus discretion that follows on Hayek's distinction between law and legislation. Focusing on a Hayekian-inspired account of social evolution, Gaus establishes conditions under which facts about cultural adaptation inform us about how well we are doing morally.

The evolutionary argument in Gaus's elegant reformulation focuses on the traditional optimization problem posed when there are multiple local optima. The powerful insight he offers takes advantage of the result in the theoretical literature that a number of less competent agents can outperform a single more competent agent, assuming as he does that solutions can be shared. The sharing of solutions requires language, often missing from the economic models put forward in the optimizing tradition. Solutions by trial and error that are then passed on to others in "rules" or "institutions" are difficult to describe. Approaches like Hayek's that stress the importance of evolved "rules" are sometimes seen to be at odds with the economists' more typical optimizing approaches because evolved rules do not carry with them their own proof of efficiency or optimality. Emily Skarbek traces the role that F. B. Kaye's celebrated edition of Bernard Mandeville's *Fable of the Bees*⁸ played in Hayek's account of social evolution as a foundation for constitutional thinking.

Christopher S. Martin explores the question of evolved institutions and the self in the polity using a rather extraordinary lens. Martin suggests that Hayek employed the political history of ancient Athens to illustrate his claims about democracy and liberty. He examines the Athenian features of Hayek's model constitution, including one rationale for the constitution, the control of factional politics. He demonstrates that Hayek's institutional proposals might have been improved had he not underrated the record of Athenian democracy. The ancient practice of citizen selection by lot for law review duties appears to avoid criticisms of Hayek's constitution while still furthering his goal of a more impartial politics.

Election by lot is an example of an evolved institution because there was no one with the statistical insight to design such a thing along probabilistic principles in ancient Athens. The Athenians seemed to

have had a rough and ready appreciation of the lot's workings but they did not fully understand its properties. One challenge for those in the Hayekian tradition is thus to examine and perhaps improve our understanding of evolved institutions. Hayek's views have also had a direct and lasting impact on policy. Several of the chapters in this book provide telling evidence of this impact. We begin the section on "Political Economy and Policy Making" with a contribution that examines Hayek's influence in Britain in the first half of the twentieth century. Using a great deal of primary evidence drawn from the time, Andrew Farrant and Nicola Tynan argue that Hayek's arguments were taken up by those who were eager to lambast Clement Attlee's postwar Labour Government. So, for example, they show that the Conservative Parliamentarian Sir Waldron Smithers frequently invoked *The Road to Serfdom* during parliamentary debates in the 1940s and 1950s and urged Winston Churchill to heed Hayek's message "to arrest the race down the road to the totalitarian State." Ekkehard Köhler and Stefan Kolev argue that Hayek connects the work of Henry Simons in Chicago with that of Walter Eucken in Freiberg. It was through Hayek and the Mont Pèlerin Society that Milton Friedman met Eucken and learned about totalitarianism from the inside.⁹

Moving forward in time and without attributing direct influence to Hayek, Jason Clemens and Niels Veldhuis review recent fiscal experience in Canada in the light of Hayekian themes. They demonstrate that the late 1980s and the entirety of the 1990s were a profound period of change and reform in Canada with reforms toward a smaller fiscal imprint for the federal government. This period of retrenchment coincided with an extraordinarily prosperous time in Canada with balanced budgets, declining debt, and tax relief coupled with a robust economy, strong job creation, and plentiful opportunities. Furthermore, Clemens and Veldhuis examine how many of the reforms enacted during this period contained a Hayekian dimension in terms of decentralizing authority and responsibility for service provision.

A third example of Hayek's influence on policy making follows, given by Václav Klaus, former president of the Czech Republic. The chapters conclude with a transcription of President Klaus's remarks, the culminating presentation at the conference. President Klaus begins with an account of how, behind the Iron Curtain, Hayek's "The Use of Knowledge in Society" became read, and widely so. It escaped the censors' prohibition because it appeared originally in the *American Economic Review*, which was too technical for them to appreciate or contraband. At about the same time, copies of *The Road to Serfdom* were published

illegally and, one senses, eagerly read in what was then Czechoslovakia. Klaus next recounts how, immediately following the Velvet Revolution, policy makers began to dismantle the institutions of communism and he, as minister of finance, oversaw the rapid and significant transformation of the Czech economy by allowing privately held companies, liberalizing, deregulating, privatizing, and desubsidizing.

We have, of course, the perfect natural experiment with which to consider policy questions and the disagreement over whether to intervene, or not to intervene: since 2008, the United States and many European nations have experienced severe contractions and sluggish recoveries. What would Hayek say about the last five years and the road to recovery? These questions, too, underscore many of the chapters in this book. Our hope is that the book as a whole and the chapters individually shed light on very practical as well as more esoteric matters.

Notes

1. The Associazione Italiana per la Storia dell'Economia Politica (STOREP) conference in 2006; see the program <http://www.storep.org/lecce2006/ProgrammaConvegnoStorep2006.pdf> (accessed May 3, 2013).
2. Friedrich A. Hayek, *John Stuart Mill and Harriet Taylor: Their Friendship and Subsequent Marriage* (Chicago, IL: University of Chicago, 1951).
3. Sandra J. Peart, "Did Mill Ruin Classical Liberalism" (lecture, STOREP conference, Lecce, June 2006). The lecture formed the starting point for the Editor's introduction to *Hayek on Mill: The Mill-Taylor Friendship and Related Writings*, ed. Sandra J. Peart, vol. 16 of *The Collected Works of F. A. Hayek* (Chicago, IL: University of Chicago Press, 2014).
4. "Fear the Boom and Bust" A Hayek vs. Keynes Rap Anthem, <http://www.youtube.com/watch?v=d0nERTFo-Sk> (accessed May 3, 2013).
5. Bruce Caldwell, ed., *The Road to Serfdom: Text and Documents—The Definitive Edition*, vol. 2 of *The Collected Works of F. A. Hayek* (Chicago, IL: University of Chicago Press, 2007).
6. See the full text of the Bishop of London's remarks from Lady Thatcher's funeral service, "The Bishop of London's Address at Margaret Thatcher's Funeral," *The Guardian*, April 13, 2013, <http://www.guardian.co.uk/politics/2013/apr/17/bishop-address-thatcher-funeral-text> (accessed May 3, 2013).
7. Theodore A. Burczak, *Socialism after Hayek* (Ann Arbor, MI: University of Michigan Press, 2006).
8. Bernard Mandeville, *The Fable of the Bees or Private Vices, Public Benefits*, ed. F. B. Kaye (Oxford: Clarendon Press, 1924), 2 vols.
9. Milton and Rose Friedman, *Two Lucky People: Memories* (Chicago, IL: University of Chicago Press, 1998), 160: "One participant who made an especially strong

impression on me was Walter Eucken of Germany. I shall never forget his pleasure at eating the first orange he had seen in seven or eight years. More important, he made vivid what it was like to live in a totalitarian country, as well as in a country devastated by war and by the rigidities imposed by the occupying authorities. His courage in resisting the Nazis became legendary. He was a teacher of Ludwig Erhard, and helped inspire Erhard's currency reform in 1948, which initiated what came to be called the German economic miracle. More generally, his theory laid the groundwork for West Germany's 'social market economy'."