

# HAYEK'S *THE ROAD TO SERFDOM* REVISITED: GOVERNMENT FAILURE IN THE ARGUMENT AGAINST SOCIALISM

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## INTRODUCTION

In a symposium on *The Fatal Conceit*, the economic historian Robert Higgs chided Hayek for ignorance of modern developments in public choice. "From reading Hayek," Higgs argued, "one would never know that public choice had been invented. Neither Buchanan nor Tullock nor any of their followers gets a single mention. Nor does Hayek show any awareness of public choice problems" [1988-89, 8-9]. According to Higgs, there is no discussion of interest groups, the motivation for voting, free rider problems, constitutional rules, etc., in Hayek's work. Granted that Higgs' discussion is limited to *The Fatal Conceit* and is not meant to address the entire corpus of Hayek's work, but the impression on the reader is that this flaw in Hayek's final work is symptomatic of something that permeates his entire body of work in economics and politics. *The Fatal Conceit* is seen as simply a restatement of Hayek's earlier works and, that, in fact, is the problem, according to Higgs. Repeating familiar Hayekian themes about rational constructivism and the informational function of the price system does not suffice as an academically rigorous foundation for classical liberalism. Not only are the political issues raised by public choice scholars ignored, but so are the "market failure" arguments that have emerged from mainstream neoclassical economics. Hayek's argument is analytically weak and rhetorically vapid, and as a result, Higgs concludes, we should not expect Hayek's argument to convince anyone who is not already deeply sympathetic to the Hayekian position.

I single Higgs out not because his discussion represents an egregious example of misreading of Hayek's work, but because he reflects a general opinion among pro-market intellectuals concerning Hayek's analytical apparatus.<sup>1</sup> In other words, while many individuals may nod to Hayek's valiant fight against socialism and in organizing an international resurgence of classical liberal political economy (especially with his efforts relating to the Mont Pèlerin Society), the belief is that he failed to address not only the revisions of socialist economic theory through the years (say post-Lange market socialist models of the kind proposed by Leonid Hurwicz or the models of workers' self-management of the type developed by Jaroslav Vanek), but also the various subtle arguments for interventionism (neo-Keynesianism and market failure theory) that had developed in the post-World War II years. Even more damning is Hayek's supposed ignorance of pro-market developments in economic science, such as property-rights and transaction cost theory, law and economics, monetarism, New

Classical macroeconomics, public choice, etc. Instead, the sympathetic critic contends that Hayek was content simply to beat the intellectually dead horse of central planning.<sup>2</sup>

While many public choice scholars will give a nod to Joseph Schumpeter's *Capitalism, Socialism and Democracy* [1942] as an early precursor, Hayek's work in political science is barely mentioned at all with regard to the historical development of public choice theory.<sup>3</sup> This is quite striking since Schumpeter did not see any theoretical difficulty in the organizational logic of socialism, whereas Hayek's work explicitly dealt with the thorny economic and political logic of socialism and democratic socialism.<sup>4</sup> Specifically, it is curious that *The Road to Serfdom* is not seen as a volume which addressed the standard public choice problems of the operation of democracy despite its extended treatment of the limits of democracy. Sir Alan Peacock, for example, in his recent book, *Public Choice Analysis in Historical Perspective* [1992, 59-60] uses Hayek as an example of a theorist who is decidedly *not* in the public choice tradition. According to Hayek's *The Road to Serfdom* the bulk of humanity, Peacock argues, reacts passively to policy initiatives. Hayek is just as guilty as Keynes, Peacock states, for implicitly rejecting the wisdom of public choice analysis when he accepts the proposition that it is ideas and not vested interests which rule the world of affairs.

*The Road to Serfdom*, though, was not limited to a critique of comprehensive central planning, i.e., the socialism of the Bolsheviks. Nor was it limited to an examination of the ideas which fostered the rise of totalitarian Bolshevism and Nazism. Rather, the book set out to explicate how socialist ideas change the demands on democratic institutions and how these institutions are in turn transformed into instruments of totalitarian rule because of their inability to meet these changing demands in a manner consistent with democratic principles. In other words, Hayek tells a tragic story—one in which the best of intentions pave the way to a hellish political, social and economic existence. "Is there a greater tragedy imaginable," Hayek asks, "than that, in our endeavor consciously to shape our future in accordance with high ideals, we should in fact unwittingly produce the very opposite of what we have been striving for?" [1944, 5].

In order to get a deeper understanding of Hayek's argument I will attempt to reconstruct his argument in *The Road to Serfdom*, survey the reaction to his argument by his contemporaries, elaborate on why his argument was misunderstood by his contemporaries and subsequent generations, and finally explain the continuing relevance of his thesis concerning the failure of government to either control or supplant the market mechanism in a manner consistent with the principles of liberal democracy.

## THE CENTRAL ARGUMENT

*The Road to Serfdom* is not the usual "political" pamphlet. The argument within the text is subtle and, in fact, its central message preoccupied Hayek for the rest of his scholarly life. Hayek took time out from technical economics, as he informed his

reader in the preface, "due to a peculiar and serious feature of the discussions of problems of future economic policy at the present time" [1944, xvii]. There is no doubt that Hayek intended to return in earnest to problems of pure economic theory, and specifically to capital theory (of which his *The Pure Theory of Capital* [1940] was only the first volume of a proposed two-volume work) after completing this book in his spare time. Hayek, however, never did return to economics. Instead, he embarked upon a new career as political theorist, historian of ideas, legal philosopher, etc. In fact, it could be legitimately argued that after 1944 Hayek moved completely out of economics proper and into social theory, and arguably emerged as one of the most wide ranging theoretical social scientists of the twentieth century. But both *The Constitution of Liberty* [1960] and *Law, Legislation and Liberty* [1973-79] are in many ways elaborations and refinements of the argument first articulated in Hayek's "political book."

*The Road to Serfdom* is divided into sixteen concise chapters that take us on a tour of intellectual history and abstract logical deduction interspersed with historical observation. The contribution of the book was to demonstrate the social consequence of ideas. In this regard, Peacock's reading of Hayek is correct, but misleading. While it is true that Hayek envisions ideas as the motive force in history, the tragedy of bad ideas is that they permit the rule of privileged interests over the common interest. Ideas provide the social infrastructure within which individuals pursue their own interest. If these ideas do not constrain the self-seeking behavior of individuals appropriately, then the result will be not only economically inefficient, but politically and socially obnoxious.

The theoretical core of Hayek's analysis was Mises's [1922] insight concerning the technical impossibility of economic calculation within a socialist system—socialism traditionally defined as the abolition of private property in the means of production. Hayek's twist on this Misesian argument was to elaborate the precise role that the price system played in providing the information (or knowledge) required for complex plan coordination.<sup>5</sup> The Mises-Hayek argument demonstrated that socialism could not replicate what the private property order and the price system provided. No one mind or group of minds could possibly possess the knowledge necessary to coordinate a complex industrial economic system. The private property order and the price system, on the other hand, through the signals of monetary prices and profit and loss accounting engendered the appropriate incentives, economized the information that needed to be processed by economic actors, and not only provided the social context for entrepreneurial discovery that was necessary for the effective use of currently available resources but led to the innovations and technological progress that assured continued prosperity [Mises, 1922, 55-130; Hayek, 1948, 77-91, 119-209].

*The Road to Serfdom* proceeds under the assumption that this Misesian theoretical proposition has been established in the technical literature.<sup>6</sup> Hayek's task in *The Road to Serfdom* was not to establish that socialist planning could not achieve the efficiency results of capitalism, but rather to demonstrate what would structurally emerge from the failure of socialist planning to achieve its desired results. The detour into intellectual history in the first three chapters was considered necessary to show

that despite the Misesian demonstration, the socialist critique of competition had effectively undermined the legitimacy of liberal institutions among the general public and especially among the intellectual elite. Hayek's assessment that one of the great advances of liberal theory was to unmask the special pleading activity of interest groups is significant when demonstrating Hayek's relevance to public choice. Liberalism, Hayek argues, had imparted a "healthy suspicion" of any argument that demanded restrictions on market competition.<sup>7</sup> With its critique of the competitive system, socialist theory had unfortunately swept away the liberal constraints against special pleading, and opened the door for a flood of interest groups to demand government protection from competition under the flag of socialist planning [Hayek, 1944, 40].

Hayek even explains how the failure of laissez-faire liberalism against socialism was born out of its success in curbing the special interests of the mercantilist type. Hayek states,

Against the innumerable interests which could show that particular measures would confer immediate and obvious benefits on some, while the harm they caused was much more indirect and difficult to see, nothing short of some hard-and-fast rule would have been effective.... [But since such a] strong presumption in favor of industrial liberty had undoubtedly been established [by the classical economists], the temptation to present it as a rule which knew no exception was too strong always to be resisted. [1944, 17-18]

Thus, if one of the theoretical claims of modern public choice theory is the demonstration of the logic of concentrated benefits and dispersed costs, then clearly Hayek understood this principle. Moreover, if one considers his argument for the economic importance of "the rule of law," then it becomes clear that Hayek sought to counter the logic of concentrated benefits with a fixed rule that would eliminate opportunities for special interest groups to capture the apparatus of the state to use for their benefit.<sup>8</sup>

Despite the reading given by Higgs or Peacock, *The Road to Serfdom* touches upon several themes central to public choice besides concentrated benefits and dispersed costs. In his elaboration of the importance of the rule of law, for example, Hayek anticipated a theme that would be continually reiterated in the work of James Buchanan. Rules, rather than discretion, by "tying the King's hands" provide the legal certainty required for the development of commercial society. Hayek [1944, 73], in fact, describes formal rules as "instruments of production," a phraseology that is echoed in Buchanan's [1975] distinction between the "productive state" and the "redistributive state."

Hayek provides one of the most articulate statements of the liberal proposition that economic freedom and political freedom are linked. This argument has often been misunderstood to suggest that economic development could occur only within a liberal political order. If that were the case, empirical counter examples could be supplied

where authoritarian dictatorships produced economic growth. The liberal argument would be refuted, or at least seriously called into question.<sup>9</sup> Hayek's argument, of course, was more limited and not so crude as to assert such a tight social causation. He argued that economic control does not control merely "a sector of human life which can be separated from the rest; it is the control of the means for all our ends. And whoever has sole control of the means must also determine which ends are to be served, which values are to be rated higher and which lower—in short, what men should believe and strive for. Central planning means that the economic problem is to be solved by the community instead of by the individual; but this involves that it must also be the community, or rather its representatives, who must decide the relative importance of the different needs" [1944, 92].

Perhaps Hayek's most important public choice contribution in *The Road to Serfdom* was in pointing out the organizational logic implied in the substitution of community decision making by its representatives to form a collective plan for the private decisions of individuals within the marketplace. His discussion entails both an examination of the incentives these representatives face in the institutional context of centralized economic planning, and the evolutionary process engendered by these institutions for the selection of leaders. Remember, in my interpretation, Hayek did not seek to demonstrate the truth or falsehood of the Misesian proposition concerning the impossibility of economic calculation under socialism in *The Road to Serfdom*. This work proceeded *as if* that proposition had already been established in the technical literature of economic theory. Thus, Hayek was examining the organizational logic of central planning and what societal/institutional transformation would occur in response to the failure of planning to achieve its stated purposes.<sup>10</sup>

Obviously, when faced with their failure, government officials could reverse course and move toward the adoption of liberal economic policies. Crucial to Hayek's argument is the public choice wisdom that government decision makers, within a social context where liberalism (and its institutions of governance) has been undermined by the socialist critique, do not face incentives which are likely to produce a choice of reversing course. This is how we get the "slippery slope" argument. Where Hayek differs from the extreme public choice interpretation of the incentives within politics is how ideas (by changing the social infrastructure) can change the incentives that officials face in policy decisions. In this regard, Hayek blends ideas and interests together in a more subtle manner than is available in textbook treatments of public choice theory, and he does so in a manner akin to Buchanan's important distinction between pre- and post-constitutional levels of analysis.

In examining the organizational logic of planning, Hayek warns the reader that since the economic knowledge necessary to plan the economy rationally will not be available to planners, these decision makers will be forced to rely on the forms of information that are readily available, which in this context comes in the form of incentives to exercise political power. Hayek's argument is an application of the principle of comparative advantage to the selection of leaders within the planning system. In other words, just as we expect the division of labor within a society to reflect the opportunity costs of the various producers, so we should expect those with

the requisite skills in exercising political power to advance within the political apparatus of planning. In this regard, Hayek was directly challenging the argument that experiments in real existing planning, say in the former Soviet Union, were tainted by "historical accident" and/or "bad" people, and, therefore, could not be employed to illustrate the difficulties with planning. It simply was not true that if only "good" people controlled the planning bureau, then the results would be harmonious with liberal democratic values.<sup>11</sup> Hayek wrote,

There are strong reasons for believing that what to us appear the worst features of the existing totalitarian systems are not accidental by-products but phenomena which totalitarianism is certain sooner or later to produce. Just as the democratic statesman who sets out to plan economic life will soon be confronted with the alternative of either assuming dictatorial powers or abandoning his plans, so the totalitarian dictator would soon have to choose between disregard of ordinary morals and failure. [1944, 135]

"Success" in this arena requires a talent for unscrupulous and uninhibited moral behavior with respect to humanity. Totalitarianism is neither a consequence of "corruption" nor "historical accident," but rather a logical consequence of the institutional incentives of the attempt to centrally plan an economy.<sup>12</sup>

Hayek, in this context as throughout *The Road to Serfdom*, is making a subtle and tragic argument about the consequences of planning. It is not just that a band of "thugs" get control of the coercive apparatus of the state and employ it to oppress the mass of citizens to their own benefit. The desire to organize economic life (or social life in general) in strict accordance to a scientific plan does not spring from a desire to exercise power over people. But, Hayek points out, the arbitrary employment of power is a consequence, and not a cause, of the desire to plan the economy scientifically. In order "to achieve their end, collectivists must create power—power over men wielded by other men— of a magnitude never before known, and ... their success will depend on the extent to which they achieve such power" [1944, 144]. Even liberal socialists, as opposed to collectivists, in their desire to plan the economy must establish institutions of discretionary planning and grant authority to the planners to exercise their political power in order to accomplish the task entrusted to them. The complexity of the task implied in rationally planning an economic system would require that planners be granted almost unlimited discretion. And, as a consequence, we should expect that only those that have a comparative advantage in exercising discretionary power will survive.

Hayek's argument was a straightforward application of economic principles to the political institutions of planning. It was an argument not unique to Hayek and should not have been a controversial proposition. Frank Knight, in fact, made quite a similar argument when he aptly stated that the planning authorities would have to

exercise their power ruthlessly to keep the machinery of organized production and distribution running... They would have to do these things whether they wanted to or not; and the probability of the people in power being individuals who would dislike the possession and exercise of power is on a level with the probability that an extremely tender-hearted person would get the job of whipping-master on a slave plantation. [1938, 869]

If public choice theory means "the economic study of nonmarket decision making or simply the application of economics to political science" [Muller, 1989, 1], then Hayek's argument concerning the organizational logic of socialist institutions is unduly neglected within the contemporary literature in political economy. Moreover, Hayek's argument was not limited to an examination of "hot" socialism, but included an analysis of the importance of rules rather than discretion, the limits of democracy, and the importance of federalism as an institutional constraint on democratic action.<sup>13</sup>

What I would like to suggest is that this neglect of Hayek's public choice contribution can be ascribed to the twin factors of *vision* and *analysis*.<sup>14</sup> The majority of his contemporaries misunderstood his insights because of visionary differences which caused them turn a deaf ear to his argument. In addition, among his contemporaries who shared his vision, precious few followed his analytical structure.<sup>15</sup> Unfortunately, even as time passed and more scholars tended to share Hayek's vision concerning the failure of government planning of the economy, their mode of analysis remained antithetical to his, and thus, his original analytical contribution was masked from their view.

### THE SPIRIT OF THE AGE

The socialist critique of the liberal economic order effectively changed the terms of the debate by the beginning of the twentieth century. Most participants in the intellectual and political debate agreed that laissez-faire liberalism had failed to provide equity and humane social conditions. Instead, progressive legislation was demanded in order to correct for the failings of free competition. The Great Depression, which by popular interpretation of the time demonstrated that not only was capitalism unjust but also unstable, contributed to the critique of laissez-faire liberalism. The capitalist system, if it was to survive in the liberal world of the 1930s, had to be subject to democratic political forces of control to tame its operation and protect the populace from unscrupulous business and irresponsible speculation.

This general intellectual climate of opinion both altered and was reinforced by the development of neoclassical economics in the 1920s and 1930s. As academic economic theory became more technically sophisticated and rarified in its presentation of its basic theorems, the more intuitive or appreciative understanding of rivalrous market processes that characterized the classical economists and the early development of neoclassical economics was dismissed as unscientific.<sup>16</sup> The flip-side of the development of the model of perfect competition and its strict required conditions, was

the development of the theory of market failure. Market failures were said to exist whenever capitalist reality did not meet the conditions of the textbook model of perfect competition. Externalities, public goods, monopoly, imperfect competition and macroeconomic instability were said to characterize real-world market economies and required positive government action to curb the socially undesirable result.

These theoretical developments colored historical interpretations. The Progressive Era in the U.S., for example, was seen as a public interest movement to rid society of social ills through positive government action. The cynicism toward proposals by interest groups to curb the forces of free competition that Hayek rightly attributes to nineteenth century liberalism was gone, replaced by an optimism of government officials to set right what was wrong with our world.

The Great Depression simply solidified the "victory" of the socialist critique of liberalism. The collapse of the U.S. and U.K. economies shook an entire generation's faith in the capitalist system. Rational planning came to be viewed as not only a viable alternative to be debated, but the only alternative to chaos. Classical liberal economic policy reflected the beliefs of the naive and simple minded. The modern world had become too complex for ideas from the eighteenth and nineteenth century to offer anything of value.

John Maynard Keynes argued that while some may cling to the old ideas of liberal economic policy, "in no country of the world to-day can they be reckoned as a serious force" [1933, 762]. The significant fact to remember is that Keynes considered himself, and was viewed by others, as a realist in the classical liberal tradition. Keynes was not a socialist radical, but rather a self-anointed savior of the bourgeois order [Keynes, 1926, 129-30]. The Keynesian idea was for government to intervene rationally to improve the workings and outcomes of the market economy. He proposed to combine the socialization of the capital market with the nineteenth-century political traditions of Great Britain. While he saw the socialization of investment as the only way of securing full employment, this change did not in his analysis require a general break with bourgeois society. Keynes conceived of his theory as an extension of classical liberalism, not a rejection. His advocacy of a greater role of government in planning the economy was, in his mind, a practical attempt to save individualism and avoid the destruction of the existing economic system [ibid., 1936, 378-81].

The spirit of the age even led someone as cynical toward intellectual and political promises of human betterment through progressive legislation as Frank Knight, to declare publicly the virtues of communism [Knight, 1932]. Knight argued that liberal society had failed to provide social order in the time of crisis, and, therefore, that communism may regrettably provide the social order so desperately needed.<sup>17</sup> It seemed as if everyone advocated some form of government control and planning of the economy to ensure stability and equity during the 1930s and 1940s. In this intellectual climate of opinion, the challenge posed to economic planning by its critics, Mises and Hayek, was neither appreciated nor tolerated. But without understanding the theoretical difficulties with planning, the eventual disappointing experience with planning attempts in both the socialist and democratic world could not be understood.

It was not just an issue of ideological apologetics; the problem was that the ideological vision produced an honest analytical blind spot in scholars and intellectuals.

The intellectual biases of the time failed to appreciate not only the economic problems of planning, but the ignored political difficulties of planning. Along with the previous era's cynicism toward pleas for restrictions against competition, the victory of the socialist critique of liberal society also eliminated the justifications for constraints on democratic government that had been developed in the eighteenth and nineteenth centuries. Hayek's discussion of this de-legitimation of liberal constitutionalism and the rule of law was one of the crucial arguments in *The Road to Serfdom* [1944, 56-87]. In order for planning to be implemented, officials cannot be constrained by formal rules, but must be entrusted with discretionary power. Moreover, planning (if it is to have any coherent meaning) requires broad agreement, and democracy is capable of only producing a certain level of agreement —usually limited to general rules within which disagreement will be tolerated. Hayek argued, "That planning creates a situation in which it is necessary for us to agree on a much larger number of topics than we have been used to, and that in a planned system we cannot confine collective action to the tasks on which we can agree but are forced to produce agreement on everything in order that any action can be taken at all, is one of the features which contributes more than most to determining the character of a planned system" [1944, 62]. In other words, "planning leads to dictatorship because dictatorship is the most effective instrument of coercion and the enforcement of ideals and, as such, essential if central planning on a large scale is to be possible. The clash between planning and democracy arises simply from the fact that the latter is an obstacle to the suppression of freedom which the direction of economic activity requires" [1944, 70].

Such a warning, though, was not going to be respected during this era. Traditional limits on democracy had to be abandoned so progressive legislation could be enacted. The classical liberal wisdom concerning constitutional constraints was lost. Instead, a naive view of democratic governance dominated discourse. A democratic political system was envisioned as one in which individual citizens could effectively determine the rules by which they would live. The voting process unambiguously conveyed the necessary information concerning the array of public goods and services demanded and the level of taxes that must be paid. Democracy was an ideal model of self-rule. The spirit of the age demanded an expansion of democratic power, not constraint.<sup>18</sup> Faced with the failures of the liberal economic order, democratic government could easily set the manner straight through the judicious use of rational planning. If government action failed, it was not due to structural weaknesses in the democratic system (such as the inability of the government to calculate the alternative use of scarce resources rationally without the signals of the market). Instead, political actors would just have to gather more information and try harder next time.

Planning and the expansion of democratic procedures into areas beyond its traditional scope were not seen as a threat to political freedom. Keynes, for example, in reacting to Hayek's *The Road to Serfdom* wrote,

I should say that what we want is not no planning, or even less planning, indeed I should say that we almost certainly want more. But planning should take place in a community in which as many people as possible, both leaders and followers, wholly share your own moral position. Moderate planning will be safe if those carrying it out are rightly oriented in their own minds and hearts to the moral issues. [1944, 387]

So long as 'good' people were in charge, nothing was objectionable with economic planning. In fact, planning was desirable.

Hayek's argument was not treated as kindly by most critics as it was by Keynes. Hayek had his supporters. For example, Joseph Schumpeter [1946] wrote a positive review in the *Journal of Political Economy*, as did Aaron Director [1945] in the *American Economic Review*. But most of the leading academic reviews were not favorable. Barbara Wootton [1945] wrote an even-handed and respectful critique of Hayek. In fact, Wootton's book was written in such a qualified manner that despite its general reputation as a critique of Hayek, many liberal writers who were sympathetic to Hayek viewed the book as a confirmation of Hayek's thesis.<sup>19</sup> Wootton was the exception as far as critics of *The Road to Serfdom* were concerned.

Herman Finer's *The Road to Reaction* [1945] set the tone. Finer accused Hayek's *The Road to Serfdom* of being "the most sinister offensive against democracy to emerge from a democratic country for many decades" [1945, v]. The true alternative to dictatorship, Finer assured his audience, was not economic individualism and competition, but a democratic government fully responsible to the people. Hayek's world, according to Finer, would leave individuals under the control of aristocrats or the moneyed bourgeoisie. But free people can govern themselves without such masters. Economic planning was simply democracy in action, and it proved itself every time there was a successful government action. Finer accused Hayek of confused and misleading language, misunderstanding the concept of the rule of law which was out of the range of Hayek's amateur comprehension, a biased understanding of economic processes, poor scholarship, historical blindness, non-existent comprehension of the basic teachings of political science, and ignorance of the science of administrative management, as well as a direct assault on the principal values of the democratic system that conveyed an attitude toward average men and women that was authoritarian.

Charles Merriam [1946] in reviewing both the Finer and Wootton volumes spent very little time on Wootton, but instead devoted most of his energy to endorsing Finer's critique vigorously. He refers to Hayek's book as "an over-rated work of little permanent value" and states that there has not been a more effective political polemic written since Henry George's critique of Herbert Spencer in the *Perplexed Philosopher*. Finer's work, in contrast to Hayek's, we are told "breathes the democratic spirit of confidence, and contains a progressive plan based upon hope rather than upon fear" [ibid., 1946, 135]. In his own review of *The Road to Serfdom*, Merriam anticipated Finer's critique of Hayek as being confused, lacking in scholarship, and arrogant, and concludes by stating contra Hayek that

[O]ut of skillful planning will come human freedom in larger measure, the growth of the human personality, the expansion of the creative possibilities of mankind. Conscious creative evolution —mastery rather than drift— marks the way to higher levels and higher orders of human life. The road to serfdom is not planning but drift, unwillingness to change, incapacity for adaptation to new possibilities of human emancipation, worship of the status quo. [1944, 235]<sup>20</sup>

Admittedly I have singled out the worst examples of critical discussion of Hayek's thesis. But Merriam's reviews were published in such prestigious journals as the *American Political Science Review* and *American Journal of Sociology*. Joseph Mayer's review of *The Road to Serfdom*, published in *Annals of the American Academy of Political and Social Science* was lukewarm—he did not really understand Hayek's point about planning, but thought the book made some important points about the rule of law in a peacetime democracy. When the *American Economic Review* ran Director's review, the editors included an opposing review by Eric Roll and prefaced the reviews with the following note: "In view of the ideological character of, and the great interest in Professor Hayek's book it was found desirable to publish two reviews written from different standpoints." Roll's review, in fact, comes close to the standard of 'scholarly' discourse established by Finer. Hayek had succumbed to the common rhetorical tactic among journalists and political pundits, Roll argues, but we should have hoped that so experienced a social scientist as Hayek would have avoided the temptation to equate socialism with nazism. Roll states,

Hayek might have stopped to reflect upon the very different development during the last few pre-war years in Germany and in the Soviet Union, and he might have had the grace, at the least, to acknowledge the very different manner in which the war itself has been conducted by the enemy and by our ally: we have yet to be shown that Maidanek is an inevitable corollary of a collective economy. The truth is that Hayek's strong political prejudices show through the veneer of reasonableness coupled with high-mindedness with which he tries to impress the reader. [1945, 180]<sup>21</sup>

The intellectual spirit of the age simply could not appreciate nor incorporate the argument put forth by Mises and Hayek into the public wisdom of the time. Their vision and analysis of political and economic processes was simply inconsistent with everything that the contemporary intellectual culture in Western democracies was suggesting circa 1930 to 1975. Even if the intellectual elite in the West expressed normative disagreements with aspects of how the Soviet Union was going about introducing a "new civilization," the attempt to bring social life under conscious and rational direction with the aid of science was to be applauded. The economic failures of the Soviet system were attributed to its historical backwardness, and the political

problems were attributed to a lack of democratic traditions within Russian history. German Nazism, on the other hand, was a consequence of the German character and the failures of capitalism, and not the corruption of liberal institutions through the intrusion of socialist principles, as Hayek contended.

Subsequent historical development seems to have persuaded many that Hayek's vision was essentially correct [Heilbroner, 1990].<sup>22</sup> Unfortunately, this does not translate into an appreciation of his analytical contribution to politics and economics, and this is no less true for those broadly sympathetic to his classical liberal vision than for those who are radically opposed to that vision.

### ANALYTICAL CONFUSIONS

Hayek was above all else an "Austrian" economist. The analytical propositions he worked with, the techniques of analysis utilized, his whole mode of operation was that of an Austrian economist. And, despite his departure from formal economic questions, this analytical apparatus remained intact. Hayek used Mengerian spontaneous order theory and Misesian market process theory to examine the emergence of private property rules, the development of the common law, the growth of commerce, the rules of moral conduct, etc. Obviously, Hayek was a unique scholar and read widely across disciplines—he could not be accused, for example, of being "economistic" in his research. My point is simply that he 'read' this information gleaned from his wide-ranging research through his Austrian analytical lenses. This point is completely missed by those preoccupied with Hayek's liberalism. Liberalism provided Hayek with a set of problems, but the way he went about analyzing these problems was thoroughly Austrian.

The visions we hold concerning "man" and "society" provide the basis of social analysis, they do not constitute it. As Schumpeter wrote, "In order to posit to ourselves any problems at all, we should first have to visualize a distinct set of coherent phenomena as a worth-while object of our analytical efforts. In other words, analytical effort is of necessity preceded by a pre-analytic cognitive act that supplies the raw material for the analytic effort" [1954, 41]. Once we have located an "interesting" problem, we then set about analyzing it, and the outcomes of our study are not neutral with regard to our method of analysis.

Hayek's Austrian style of analysis, however, fell out of favor in the 1940s and has remained outside the mainstream of economic thinking ever since. To go back to my introductory thesis, public choice economics was the application of mainstream economic analysis to political decision making. The mainstream tenets of economic analysis are: (1) maximizing behavior, (2) stable preferences, and (3) equilibrium. Austrian economists, and Hayek in particular, reject at least two of these tenets, if not all three.<sup>23</sup> Hayek, for example, rejects the homo-economicus assumption as part of the rationalist tradition as opposed to the evolutionary tradition in which he places his own work [1960, 61]. Moreover, Hayek was highly critical of the apparatus of perfect competition and the preoccupation of economists with equilibrium analysis [1948, 77-106].

Thus, Hayek's contributions to public choice analysis come in the form of the application of *Austrian* economic theory to decision making within non-market settings. I would stress even further, that it is Austrian *capital theory* where the differences between Austrian and other marginalist economists are most acute.<sup>24</sup> In mainstream economic analysis, the strict application of the three tenets above mask the complexity of the capital structure, and the issue of coordination. But in Austrian analysis the coordination of plans through time (and in an environment of uncertainty) takes center stage, and the various key *positive* propositions derived in Austrian theory (such as relative prices signals, profit and loss accounting, heterogeneity of capital, complementarity of capital goods, etc.) are employed to derive a theory of how complex plans dovetail in an industrial economy. In short, the manner in which Austrians explain the "equilibrium" outcome of market processes (if we can even use that term) is radically different from the conception within the mainstream, and as such represents a different analytical contribution to economic science. The difficulty of coordinating economic plans through time, and the vital role that a functioning capital market plays in guiding that process, focuses theoretical attention on the issue of economic calculation and entrepreneurial discovery. In a standard circular flow model of the capitalist economy, on the other hand, these problems are not highlighted in the formal presentation because the underlying assumptions solve the problem of coordination by calculation by hypothesis. It is not the political-sociological vision that makes Hayek so different from other scholars; it is his analytical apparatus which forces scholars to pay attention to the dynamic capital structure of an economic system. What is most challenging to mainstream economic scholars is that if Hayek's position is proven to be more robust, then a major recasting of post-World War II developments in economic science would be in order.

Standard public choice analysis followed the path of mainstream neoclassical economics. The Virginia School, however, did not follow completely in line with the mainstream, but certainly the Chicago School of public choice analysis did—with the result that many of the institutional inefficiencies of government action are often not recognized because the equilibrium analytics do not permit their examination.<sup>25</sup> If, on the other hand, disequilibrium adjustment processes form the core of one's analytical structure, then inefficiencies and imperfections, and the way individuals respond to this situation, are crucial to the analysis. Institutions, and the incentives and information they engender, drive the analysis. Economic outcomes are not invariant with respect to institutions—including forms of democratic governance.

Public choice analysis in the Austrian tradition would emphasize the *structural ignorance* actors must confront in situations outside the context of the market economy.<sup>26</sup> The Arrow theorem, for example, could be reinterpreted as an application of Mises' impossibility thesis to non-market decision making via democratic voting. Absent the price system, actors would confront a set of incoherent signals about how they should orient their behavior. Rather than rely on the competitive bidding of the market, the community must decide on how to allocate a scarce resource, say a vacant lot. The lot could be used for (1) a community park, (2) an elementary school, or (3) a parking garage. Without the price system to guide resource use, community

agreement must emerge. But, as Arrow demonstrated, even in a simple example such as this one, majority-rule pairwise voting might not produce the required agreement (a highly formal result which echoes Hayek's discussion of limits of democratically derived agreement in *The Road to Serfdom*). The park may win against the school, and the school may win against the parking garage, but the parking garage would win over the park—violating the mathematical principle of transitivity. The well-known result is that given this problem the outcome can be efficient only if the political system is dictatorial, or allocations can be inefficient, but democratic. There simply is no manner in which allocations can be efficient and derived democratically.

One line of argument favored by some public choice scholars, such as Buchanan and Tullock, was to charge this result with being trivial. Why should we be surprised? Only a naive view of democracy would have expected that individual preference rankings could be aggregated cleanly to convey unambiguously the "will of the people." This was a perfectly reasonable response by scholars working within a constitutional democratic tradition. But, the Arrow result was important precisely because it should have burst the bubble of naive democracy of the type that informed Finer's critique of Hayek. And, moreover, to go back to my introductory remarks concerning the Higgs-type critique of Hayek—this challenge to the ability of democratic government to produce agreement beyond a certain limited range of issues informs the Hayekian examination of public goods (i.e., what are the demand revealing processes in public goods provision, and what institutions would compensate for the calculational difficulties in non-market allocations?), and externalities (i.e., what property rules and/or contract technologies would internalize external effects?). This is why, for example, in his examination of public goods problems in *Law, Legislation and Liberty*, despite his acceptance of certain aspects of the analytical arguments of standard market failure theory Hayek nevertheless derives an entirely different conclusion concerning the production and distribution of public goods. In particular, Hayek argues for a non-exclusive position for the government even when it can be technically determined that under *current circumstances* only government would in fact be able to supply the good in question. This argument is not a result of "bad economics" combined with wishful ideological thinking (e.g., assuming away free-rider problems), but rather emerges from Hayek's analytical consideration of the dynamics of technological change and his recognition that the informational requirements of matching demand and supply of *any* good are dependent upon the institutional context within which that process is to take place [Hayek, 1973-79, vol. 3, 41-64]. Hayek is not ignorant of public choice problems; he just alters the analytical treatment of these problems in certain directions that differ from more traditional treatments in the literature.

The inability of democracy to ensure agreement means that theorists must recognize the limits of democratic decision making and focus scholarly attention on the governance structures that permit efficient outcomes to result. The political process, just like the market process, should not be expected to generate optimal allocations. Both are imperfect. Unlike the market process, however, democratic politics does not engender the incentives and information for its own error detection and correction.

The type of spontaneous adaptations that occur in the market to correct current inefficiencies cannot be expected to emerge in the political process. Instead, conscious direction and rule making are needed. Rather than spontaneous adaptation, politics requires conscious adaptation, and there are epistemological limits to this procedure.

## CONCLUSION

Hayek's *The Road to Serfdom* is as relevant today as when it was published fifty years ago, perhaps more so. At the time of publication it constituted a warning to the liberal democratic West that the road to totalitarianism was not paved by revolutionary bandits, but instead by high ideals. Today, we are witnessing the collapse of the state socialist system, and the attempt to transit the path to political democracy and economic prosperity. We will not find an answer to these problems by reading Hayek's great book. What we will find, however, is a set of analytical tools and insights that we can employ to address the problems of our modern world.

In this regard, we are left by Hayek (1) a refined statement of the Misesian proposition concerning the impossibility of economic calculation in the absence of private property, and (2) an examination of the organizational logic of institutions designed to replace the private property system in allocating scarce resources. The strength of Hayek's analysis was to show that this logic was not a function of the form of government which inspired the substitution of collective decision-making for the private choices on the market. Whether democratic or authoritarian in legitimation, the institutional incentives produced a logical pressure toward totalitarianism.

In Eastern and Central Europe and the former Soviet Union this logic is misunderstood when the intellectual elites insist that democratic politics be held up as the revolutionary value of 1989, and not economic freedom. That there can be no meaningful political freedom without a large degree of economic freedom was the core political-philosophical claim of *The Road to Serfdom*, a claim derived from an analytical argument concerning the nature of the planner's task. It will indeed be a hollow victory if the revolutions of 1989 end up by simply rejecting the totalitarian rule of the Communist Party only to embark upon a process of multi-party sanctioned dictatorship in the quest to control the process of transition. Already most of Eastern and Central Europe have failed to incorporate the constitutional lessons of liberal democracy. We are in a constitutional moment, but it still does not appear that the "democratic fetish" that Hayek warned about has subsided. Moreover, we have to convey forcefully to the people in the former Communist Bloc countries (and our own) that not all forms of democratic rule are equally effective with regard to safeguarding the market economy. Unless "enabling" institutions are established and the spontaneous adjustments of markets are permitted to guide economic decision making, the poverty of one terrible period will only be replaced by the continued poverty and disappointment of a people who have endured so much already.



## NOTES

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1. For example, I am not contesting Higgs's claim that Hayek does not cite the contemporary public choice literature. Hayek, indeed, does not cite this literature, nor does he cite contemporary work in Austrian economics. His failure to cite either line of literature, however, should not be taken as evidence of his lack of treatment of the issues developed in either of these literatures. Hayek is no less of an Austrian economist because he fails to cite the work of Israel Kirzner and Murray Rothbard, let alone Mario Rizzo, Gerald O'Driscoll, Roger Garrison, Lawrence White and Don Lavoie, and an interpreter of his work would be "misreading" Hayek to suggest otherwise. Similarly, the fact that Hayek does not cite the work of Buchanan, Tullock, or other public choice scholars, should not be read as a disregard for the analytical issues raised in the public choice literature.

Moreover, I am not contesting Higgs' contention, expressed in private correspondence dated 16 June 1994, that Hayek's public policy positions leave much to be desired from a libertarian position. This is a point recently emphasized by libertarian theorists, such as Hans-Hermann Hoppe [1994] and Walter Block [1994]. These thinkers are undoubtedly correct, Hayek is not a modern libertarian. I am not suggesting that people read Hayek for libertarian policy prescriptions, but for a series of analytical arguments which will improve our understanding of the organizational principles of political processes. The fact that, in my own view, if one consistently pursues these analytical arguments they will generate libertarian policy positions far beyond the imagination of Hayek is beside the point of the present paper.

2. This opinion misses out on the strength of Hayek's research program and its unity throughout his career. Very little of Hayek's work, in fact, is devoted to a critique of central planning, though this critique forms the core of his analysis of various alternative proposals for government action to direct the economic process (including the demand and supply of public goods, the issuance of currency, the contrast between legislation and common law, etc.). One of the most disappointing features of the published obituaries on Hayek was their lack of appreciation of the economic theory underlying Hayek's political liberalism (i.e., the private property, limited government program of classical liberalism). But Hayek's liberalism was shaped by his Austrian understanding of the nature of economic processes. Thus, the subtle critique of central planning is much more an issue of general economic theory than public policy. This theoretical critique permeates all of Hayek's work from capital theory to legal philosophy. In this regard see Kirzner [1991] and Boettke [1992a].
3. For example, in neither Dennis Muller's [1989], Joe Stevens' [1993] or David Johnson's [1991] basic textbooks on public choice economics does Hayek warrant even one mention in the index or bibliography. Within the constitutional political economy group of scholars, though, Hayek's work appears to be more fundamental to the core of theory development as is evidenced by a quote from Hayek which adorns the masthead of the journal, *Constitutional Political Economy*. Moreover, it is quite clear that Buchanan and Vanberg represent the two modern scholars within the public choice tradition who have devoted the most energy to incorporating (and/or revising) Hayek's work on law and politics to forge a revitalized political economy and social philosophy. Special mention, however, should also be made of Gordon Tullock's—in my opinion sorely undervalued—examination of

bureaucratic planning where the Hayekian argument concerning the "knowledge problem" forms the core of his crucial third section [Tullock, 1987, 120-220].

4. On Schumpeter's assessment of the economic and organizational logic of socialism see Schumpeter [1942, 172-199; 1954, 989]. If socialism was to confront any problems in operation, Schumpeter asserted, then it would be at the level of practical administrative difficulties and *not* in the realm of pure economic logic as Mises and Hayek contended.
5. In Boettke [1993, 46-56], the Mises-Hayek critique of socialism is examined in each of its constituent parts—property incentives, informational complexity, the contextual nature of knowledge, and political organization.
6. As I will argue, it is this assumption which led to many of the misunderstandings concerning Hayek's work because many—even those sympathetic with liberalism—did not understand the import of Mises's demonstration.
7. See Raico [1993] and Hoppe [1993, 93-110] for an examination of interest group theory in classical liberalism in general and Austrian economics in particular.
8. See, for example, Hayek [1944, 77] where he argues that: "Those most immediately interested in a particular issue are not necessarily the best judges of the interests of society as a whole. To take only the most characteristic case: when capital and labor in an industry agree on some policy of restriction and thus exploit the consumers, there is usually no difficulty about the division of spoils in proportion to former earnings or on some similar principle. The loss which is divided between thousands or millions is usually either simply disregarded or quite inadequately considered." "Fairness" in planning, Hayek goes on to argue, would require that the gains and losses of policies be equally considered by the planning authority, but given the complex chain of events and the indirect nature of the effect of policies there is no compelling reason why the costs "divided between thousands or millions" would be adequately incorporated into the decision making process. The discretionary nature of planning, however, forces the authorities to make more and more judgements precisely of these kinds. Abandoning the rule of law for the discretion of planning, Hayek argues, amounts to an unintended return to the rule of status rather than contract.
9. See, for example, Przeworski and Limongi [1993] for this type of argument. There are several problems that immediately come to mind. First, this was not the liberal argument put forth by either Hayek [1944] or Friedman [1962]. Second, the analysis assumes that economic development is synonymous with growth rates (i.e., the difficulties of aggregate economics are not adequately addressed). Finally, the *de facto* political structure of the society in question is left unexplored in these studies. For example, in contemporary China, much of the "success" of the economic reforms can be attributed to the *de facto* political decentralization that occurred in the mid- to late-1980s [Weingast, 1993, 33-40].
10. It is not impossible to attempt to centrally plan a complex industrial economy, it is only impossible to do so "successfully." Success here means achieving the stated socialist ends of increased prosperity, efficient use of resources, elimination of the business cycle, elimination of monopoly power, and an equitable distribution of wealth.
11. As we will see later, this is where Hayek departed company with Keynes. It is somewhat ironic that Oscar Wilde—and not Keynes—saw the impossibility of mixing socialist economic planning with bourgeois values. Wilde argued in his essay "The Soul of Man Under Socialism" that perhaps socialism would yield a better economic performance than the market economy, but it would destroy artistic freedom. Hayek's argument would simply compound the Wilde-type case against socialism by pointing out that the socialist system could not out-perform the market society on the economic front either.
12. For an application of this Hayekian-type argument to the debate over the rise of Stalinism within the Soviet context see Boettke [1990, 34-8]. For an application of the argument in the context of decentralized socialism, such as the Yugoslavia case, see Prychitko [1991].
13. Hayek discusses federalism in *The Road to Serfdom* in the chapter, "The Prospects of International Order", [1944, 219-38]. Also see Hayek [1948, 255-272] and [1960, 176-192].
14. On the issue of *vision* and *analysis* in economic reasoning see Schumpeter [1954, 41-45].
15. For example, consider Frank Knight's [1936; 1938, 867-868] dismissal of the crucial Misesian argument concerning the impossibility of economic calculation under socialism. Knight believed that the problems with socialism were political and not economic. However, see Knight [1940] where he

argued that the fundamental economic problem of socialism arises due to the dynamic nature of economic life which demands continuous adjustment and adaptation on the part of economic decision makers in response to ever-changing conditions—which, of course, was a key component of Mises' original argument [Mises, 1922, 105, 120-121].

16. For a contra-Whig history of thought with regard to the tool-kit of economic analysis, and namely the model of perfect competition, see Machovec [forthcoming].
17. Milton Friedman has pointed out to me, in private correspondence concerning this paper dated 9 August 1994, that when Knight was asked later for permission to reprint these lectures, he replied "I wish I could unprint them."
18. Hayek understood this development quite well and directed a criticism against what could be termed the "democratic fetishism" of the time, or as he put it,

The fashionable concentration on democracy as the main value threatened is not without danger. It is largely responsible for the misleading and unfounded belief that, so long as the ultimate source of power is the will of the majority, the power cannot be arbitrary [sic].... There is no justification for the belief that, so long as power is conferred by democratic procedure, it cannot be arbitrary; the contrast suggested by this statement is altogether false: it is not the source but the limitation of power which prevents it from being arbitrary. Democratic control *may* prevent power from becoming arbitrary, but it does not do so by its mere existence. If democracy resolves on a task which necessarily involves the use of power which cannot be guided by fixed rules, it must become arbitrary power [1944, 71, emphasis in original].

19. See, for example, Frank Knight's review [1946] in which he suggests that "comparatively little is explicitly said which Hayek, or any opponent of 'planning,' in its current meaning of 'planned economy' (a more appealing synonym for state socialism), would need to disagree." As Knight goes on to argue, the dominant impression one gets after reading the book is "one of glaring contradiction between the tone and evident implications of virtually the whole argument and the definite commitments to any position on social policy." Also see the lengthy review of Wootton's book by John Jewkes [1946].
20. Also see Merriam's radio debate with Hayek over *The Road to Serfdom* as transcribed in Hayek [1994, 108-123]. The general tone of negative reviews in leading scholarly journals was not limited to Hayek. In reviewing Mises's *Bureaucracy*, Harvard professor Pendleton Herring wrote, "If this volume were written as a campaign document, it would merit attention at the technical level as a contrivance for obfuscating debate in accordance with the adage: 'If you can't convince them, confuse them.' It is offered, however, as a serious piece of analysis." What annoyed Herring the most about Mises's book? Apparently, Mises's insistence that the "the main issues of present day politics are purely economic and cannot be understood without a grasp of economic theory." We do not need, Herring informs the reader, "a course in economic theory as preached by the 'Austrian School'" [1945].
21. Suffice it to say that the "last few pre-war years" in the Soviet Union constituted the political purges of the 1930s, as well as the consequences of the Collectivization and Industrialization on the masses. All three Stalinist policies combined to form a policy of genocide as horrific as those instituted by the Nazis as has now been established in the historical literature by such ideologically diverse scholars as Robert Conquest and Roy Medvedev.
22. For a response to Heilbroner's argument that Mises and Hayek possessed a more prescient vision, though not necessarily correct economic analysis see Boettke [1992b].
23. The tenet in question would be stable preferences. Austrian economists agree with mainstream theorists that economists do not have much of value to say about the origin or source of preferences. However, that is not the same as strictly holding the assumption of stable preferences through time. In the Mises-Rothbard analysis of "demonstrated preference" individual preference mappings could indeed be ever-changing.
24. Frank Knight understood the central importance of capital theory to the analytical structure of Austrian economics, and that is why as a critic, he devoted so much of his review of Mises' *Nationalökonomie* to the issue, when in fact Mises' tome did not devote much space to an explicit treatment of capital theory. Appearances can be deceiving, however, because actually Mises's book is—as Knight was suggesting—almost exclusively about capital theory [Knight, 1941].

25. Instead, the equilibrium of any policy set is explored as, for example, when Gary Becker [1991, 369-374] explains the Social Security System as an equilibrium response to the "market failure" in the human capital market, or when George Stigler [1992] suggests that subsidies to the sugar industry are an efficient outcome by evidence of the fact that nobody has been able to provide a lower cost alternative. Also see, Becker [1985] where the theoretical argument for the "efficiency" of the competitive process among pressure groups in a democratic system (i.e., a system with a large degree of access to the political system) is laid out. The Virginia School, on the other hand, seeks to expose the economic inefficiencies associated with many public policies. The real question which must be raised is whether they can consistently explore these problems while retaining their commitment to neoclassical price theory. In private correspondence dated 13 September 1994, Gary Becker has objected to my interpretation of Chicago political economy. I cannot address his concerns in the present paper, but I do think the notions of equilibrium and efficiency, whether in market or political environments, are more troublesome than is usually admitted in the Chicago-style studies in political economy. Many of the philosophical, methodological, and economic theory issues associated with the Chicago notion of efficiency are addressed by scholars from various schools of thought in the symposium "Can Economists Handle Change?" in the research annual *Advances in Austrian Economics* [Boettke and Rizzo, 1994, 3-196].
26. A tentative attempt at producing a modern hybrid Austrian-public choice theory of the political process can be found in Richard Wagner [1989, 207-212]. For an application of this type of theorizing to the political-economic situation in the former Soviet Union and in particular the Gorbachev era see Boettke [1993].

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