



# HAYEK'S CRITIQUE OF CONSTRUCTIVISM: A LIBERTARIAN APPRAISAL



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 **Libertarian  
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GARETH WILLIAMS

## 1. HAYEK'S SPONTANEOUS ORDER THEORY

This Chapter will explicate and evaluate the nature of Hayek's spontaneous order theory. In so doing we will consider the opposing concepts of 'spontaneous' and 'constructed' orders, and will demonstrate the analytical superiority of these concepts of order to the false dichotomy of 'natural' and 'artificial' orders. We will look at how Hayek derives all social institutions such as law, morals and property, from his theory of spontaneous order. Hayek's advocacy of spontaneous order will be shown to derive from the notion of an evolving society, and will be related to his central concern with epistemology. It will be concluded that while Hayek's epistemology and theory of spontaneous order offer compelling reasons for opposing constructivism, the thrust of their argument suggests the need for a much more radically decentralised order than Hayek acknowledges. It will be shown that the concept of an evolving society cannot be fully fulfilled under central control, and would be better achieved by the adoption of a decentralised 'liberal metautopia'.

### SPONTANEOUS AND CONSTRUCTED ORDERS

Hayek defines 'order' as:

... a state of affairs in which a multiplicity of elements of various kinds are so related to each other that we may learn from our acquaintance with some spatial or temporal part of the whole to form correct expectations concerning the rest, or at least expectations which have a good chance of proving correct.<sup>1</sup>

He further states that "This matching of expectations that determine the actions of individuals is the form in which order manifests itself in social life".<sup>2</sup> So Hayek defines order as a system of relations which possess a regularity and predictability from which the order can be understood. As such a social order can be any arrangement which possesses regularity, by describing order in such manner Hayek is distancing the concept from any necessary connection with purposive control or central direction. Hayek says that two types of order can be shown to exist, he labels these as exogenous orders (constructions), or endogenous orders (self-generating orders). Hayek believes that it is the self generating order which characterises the origins of society.

In arguing that society has its origins in a spontaneous process Hayek points to the false dichotomy which exists between the Greek conception of 'natural' and 'artificial' orders. The failure of the Greeks to distinguish between the terms 'nomos' (meaning by convention) and 'thesi' (meaning by deliberate decision) led to:

... the situation where one author could argue with regard to a given phenomenon that it was artificial because it was the result of human action, while another might describe the same phenomenon as natural because it was evidently not the result of human design.<sup>3</sup>

Realising that there existed social institutions which could, depending on how one defined 'natural' and 'artificial', be described as either, Hayek preferred to draw attention to the dichotomy between spontaneous and constructed orders; defining the former, with the words of Ferguson, as "the result of human action but not of human design".<sup>4</sup> A spontaneous order is an order which develops as a result of conventions which characterise human interactions, while a constructed order would be one in which the institutions, morals, and laws of society were deliberately selected in advance of the establishment of the order. Hayek rejects Cartesian dualism, which he labels as:

... the conception of an independently existing mind substance which stands outside the cosmos of nature and which enabled man, endowed with such mind from the beginning, to design the institutions of society and culture among which he lives.<sup>5</sup>

So Hayek is asserting that the mind is shaped by society and thus cannot shape society independently of the society it seeks to shape; this precludes any possibility of society being a deliberate creation of human rationality as it locates rationality as being grounded in society. Hayek explains the origins of morality by reference to his theory of social evolution, quoting Clifford in saying that "Our sense of right and wrong is derived from such order as we can observe".<sup>6</sup> So morality is not determined *a priori* by society, but rather represents an agreed code of behaviour which has evolved because of the benefits it delivers to the society which upholds the code of behaviour.

Hayek's thought can be compared with that of Vico who rejects the notion of a fixed human nature and of "eternal truths, and unalterable laws, rules of conduct which entail ends of life which any man might, in theory, have recognised in any time and in any place".<sup>7</sup> Vico replaces the notion of fixed human nature with a concept of systematic change, portraying men as "purposive beings whose modes of thought, feeling and action alter in response to new needs and activities, which generate new institutions, entire civilisations which incarnate man's nature".<sup>8</sup> In perceiving the origins of the development of the order which characterises modern civilisation as a spontaneous growth, Hayek is asserting that the social institutions which comprise that order have evolved naturally, and thus are not the result of deliberate design. This view of the spontaneous order is contrasted with the Cartesian tradition which Hayek labels as 'constructivist rationalism' defined as "a conception which assumes that all social institutions are, and ought to be, the product of deliberate design".<sup>9</sup> Hayek goes on to state:

This intellectual tradition can be shown to be false both in its factual and in its normative conclusions, because the existing institutions are not the product of design, neither would it be possible to make a social order wholly dependent on design without at the same time greatly restricting the utilisation of knowledge.<sup>10</sup>

## THE EVOLUTION AND DISPERSED NATURE OF KNOWLEDGE

Hayek's epistemology is crucial to his theory of the origins of society. Hayek perceives knowledge to be imperfect, decentralised, and as impossible comprehensively to collect. The dispersed nature of knowledge militates against a constructed society since it ensures that no one mind can possess the knowledge required to understand the consequences of a social order. In perceiving society to be complex Hayek asserts that this complexity is incompatible with a command based order, believing this to be unable adequately to utilise knowledge of relevant facts about society. In presenting this attack on constructivist rationalism Hayek is asserting the existence of permanent limits on factual knowledge which militate against constructivism. The institutions which characterise modern civilisation were not selected because of the benefits it was realised they would bring; they evolved because those societies which practised them flourished, survived, and spread their influence, while those which didn't were less successful and faded away. Social institutions owe their origin not to human understanding, or rationality, but rather to social evolution. The theory of social evolution presented requires individuals to follow the rules of society, but does not require those individuals to be aware of the reason for doing so; the rules are known because they "manifest themselves in a regularity of action ... this regularity of action is not the result of the acting persons being able to state them".<sup>11</sup>

These rules must have certain characteristics which enable those who follow them to survive and prosper, if the rules the society adheres to are devoid of such positive effects then the society which adheres to the rules will fail to survive; without the survival of the society the rules cannot receive the intergenerational transmission upon which they depend, and thus will die out. A series of rules which required their adherents to run away from each other, or to fight to the death, would not produce an order which would flourish and survive; consequently a process of evolution would fail to perpetuate the existence of such rules. Society can exist "only if by a process of selection rules have evolved which makes social life possible".<sup>12</sup>

The evolution to which we refer is distinct from Social Darwinism. The transmission of rules is not genetic but social, and the process of selection operates on societies, not individuals. It should also be noted that this is not a Marxian theory of evolution. It does not see society as needing to pass through a necessary series of specific succeeding stages, or as having any end goal; rather evolution is characterised as an eternal process leading in an unpredictable direction.

The mechanism through which rules are transmitted is not made clear in Hayek's thought, however he does state that:

We cannot consider here the difficult question of how men can learn from each other such, often highly abstract, rules of conduct by example or imitation ... This is a problem most familiar to us in the learning of language by children ... but it also occurs in such fields as manners, morals, and law, and in most skills where we are guided by rules which we know to follow but are unable to state.<sup>13</sup>

Hayek seems to suggest that some innate capacity exists which enables mankind to learn rules of conduct through culture. Anthropological studies which demonstrate rule following behaviour in societies devoid of coercive control could be cited in support of this claim.<sup>14</sup>

A direct link exists between Hayek's theory of spontaneous order and his epistemology. This link suggests that modern civilisation rests upon certain general rules being adhered to, and that the complexity of modern civilisation can only be attained, and maintained, by such general rules of conduct. Hayek's epistemology asserts that knowledge is diffuse and impossible

comprehensively to collect. The constructivist belief that rationality can overcome epistemological difficulties is linked to an admiration for, but misunderstanding of, advances in the natural sciences. While scientific investigation can generate theories to explain certain phenomena, it cannot help in the process of accumulating dispersed facts, for the "limitation of knowledge with which we are concerned is ... not a limitation which science can overcome".<sup>15</sup>

It could be argued, contrary to Hayek, that modern communications and information processing systems can aid the process of accumulation, digestion, and dispersal of knowledge, thus enabling effective central planning. However the force of this argument is limited, for, as Hayek notes, with regard the use of computers, "however great their power of digesting facts fed into them, they do not help us in ascertaining these facts".<sup>16</sup> As we will see in chapter two Hayek considers information (including subjective individual preferences) to be widely dispersed throughout society, and rapidly changing in nature. In this comment upon the value of computers he is suggesting that they do not serve to overcome the logistical difficulties involved in continuously gathering rapidly changing and widely dispersed information. It is reasonable to assert that such is the nature of the knowledge to be collected that advances in communications technology are unlikely to be able to overcome these logistical difficulties. This observation is crucial to Hayek's critique of constructivism since it demonstrates that the advance of human knowledge about the world in which we live does nothing (or at least very little) to rectify the problems which frustrate successful central planning. While technological advances could offer some benefit to the collection of information they are not able to satisfy the epistemological requirements necessary for central planning.

Hayek further observes that the purpose of science is misconceived, it being widely believed that science aims to tell us 'what is', when in fact the main value of science is to tell us 'what could be'. As Hayek states:

... the value of science consists largely in telling us what would happen if some facts were different from what they are. All the statements of theoretical science have the form of 'if ..., then ...' statements, and are interesting mainly in so far as the conditions we insert in the 'if' clause are different from those that actually exist.<sup>17</sup>

Hayek considers this observation to be a powerful indictment of the work of social scientists who confine themselves to the study of what exists; he says that such work is "largely irrelevant for most decisions about the future".<sup>18</sup> He goes on to say that "[f]ruitful social science must be ... a construction of hypothetical models of possible worlds which might exist if some of the alterable conditions were made different", and in obvious agreement with Popper that "All scientific knowledge is knowledge not of particular facts but of hypotheses which have so far withstood systematic attempts at refuting them."<sup>19</sup>

The belief of Cartesian rationalists in their ability to conquer the knowledge problem is characterised by Hayek as being implicit rather than explicit within their theory. Those who engage in constructivist rationalism use a provisional assumption of complete knowledge but believe that this assumption can later be dropped without much affect on their conclusions, "the argument then proceeds as if ignorance did not matter".<sup>20</sup> In so doing constructivists fail to take seriously the problem of epistemology, and prove unable to understand the role of general rules which characterise modernity. The knowledge which is used by the institutions which characterise modernity does not need to be known by the individual for the individual to benefit from it, as:

In a civilized society it is not so much the greater knowledge the individual can acquire as the greater benefit he

receives from the knowledge possessed by others ... Indeed, a 'civilized' individual may be very ignorant, more ignorant than a savage, and yet may greatly benefit from the civilization in which he lives.<sup>21</sup>

So Hayek is asserting that an individual can benefit from the improved use of knowledge in society without necessarily having any more knowledge himself. In so saying Hayek is describing capitalism as an intricate and complex machine in which each individual component need only play its role and need not understand the overall workings of the machine.

This description of the use of knowledge is characteristic of Hayek's theory of epistemology; his main critique of socialism is based not upon the problem of calculation (as for Mises) but upon knowledge of relevant facts. Hayek perceives an economic order which is open to, and encouraging of, entrepreneurialism, as essential to the acquisition and utilisation of information which is both localised and in a state of flux.

## PROBLEMS

The general rules which maintain modernity and enable future development and progress are not of a fixed character, but rather can, and should, be adapted to facilitate the growth of a complex order which can alone provide improved conditions for the use of knowledge. Hayek rejects assertions that such general rules can be characterised as private property and freedom of contract, as exponents of laissez-faire believe, but approves of a role for government to maintain a framework for the market, arguing:

Our problems begin when we ask what ought to be the contents of property rights, what contracts should be enforceable, and how contracts should be interpreted or, rather, what standard forms of contract should be read into the informal agreements of everyday transactions.<sup>22</sup>

He goes on to say that the function of government:

... is somewhat like that of a maintenance squad of a factory, its object being not to produce any particular services or products to be consumed by its citizens, but rather to see that the mechanism which regulates the production of these goods and services is kept in working order.<sup>23</sup>

Although this position is later watered down when he states that:

The same organization that is charged with keeping in order an operating structure which the individuals will use for their own purposes, will, however, in addition to the task of enforcing the rules on which that order rests, usually be expected also to render other services which the spontaneous order cannot produce adequately.<sup>24</sup>

In conceding that the state should, in addition to providing the structure to maintain civilisation, also provide 'other services', Hayek makes it clear that his theory is not designed rigidly to limit the role of the state. Instead the theory so far developed serves only to oppose a false theory of constructivist rationality which seeks to take overall control of society, and design it in accordance with rationalist principles.

In similar vein Hayek notes, with regard to law, that:

Although undoubtedly an order formed itself spontaneously because the individuals followed rules which had not been deliberately made but had arisen spontaneously, people gradually learned to improve these rules; and it is at least conceivable that the formation of a spontaneous order relies entirely on rules that were deliberately made.<sup>25</sup>

It is here that we can detect the conflict within Hayek's thought, between the hostility to rationalist planning and the nature of the positive role that he deems appropriate for the state. As earlier shown, Hayek's theory is not designed to limit the state

either in terms of expenditure as a fixed share of the national wealth, nor in terms of being limited to certain tasks. Yet, as parts 2 and 4 will highlight, Hayek considers the state to have assumed too many responsibilities. He advocates that the state do only the right things, that is, to undertake limited action to correct for certain market failures, but not to engage in planning; his critique of constructivism is designed to ensure that the state does not continue along this mistaken path.

Yet problems still exist with this theory. Firstly it supposes that the state can be constrained to only those tasks which are appropriate to it. Secondly, and more importantly, it neglects the fact that the functions of the state are not open to the same kind of selection process which Hayek uses to explain the origin of social institutions. The first problem could be responded to with an assertion that the theory is designed to demonstrate the principles which should guide state action, and as such stands, irrespective of its ability to limit state action to the principles mentioned. This could be accepted as an adequate response. However at various points<sup>26</sup> Hayek does attempt, through reference to principles, and more substantially through the design of a model constitution, to demonstrate how the state can be prevented from engaging in constructivism. While value does exist in these attempts it remains the case that institutions develop their own inertia which changes their nature from that originally intended.

It is here that the second problem begins to develop its significance. Hayek explains the origins of social institutions through reference to the spontaneous process of evolutionary selection. Yet such selection has its relevance diminished by political institutions which have the power to suppress developments which may challenge their existence. Indeed, more generally, it seems that evolutionary selection of social practices can be impeded by governmental power which, due to its coercive nature, is semi-insulated from the effects of competition. Such competitive pressures, which formed an integral part of Hayek's theory of the spontaneous development of rules, are not however totally missing from the political process. Competitive pressure do exist in a climate of freedom of trade and movement, when capital and people can be relocated between different areas of legal jurisdiction. Hayek's advocacy of decentralised political control is to this extent welcome, and consistent, indeed necessary, to the competitive selection of rules.

However, as Shearmur asserts, the seeming logic of Hayek's argument from the perspective of the competitive selection of rules, which lies at the heart of his theory of spontaneous order, is the development of a much more radically decentralised order than is acknowledged in Hayek's work. Shearmur labels this as a liberal metautopia which is based on Nozick's framework for utopia as advocated in *Anarchy, State and Utopia*. This framework would enable the central provision of those services which Hayek considers can be provided only by a centralised coercive authority (such as external defence<sup>27</sup>) while allowing all other functions of government to be performed by (almost completely) autonomous governmental units. Shearmur asserts that these units would be constitutionally sovereign in all but two respects. Firstly they would have to contribute to the external defence of the 'metautopia'. Secondly they would have to guarantee freedom of exit to any citizens who wished to leave (no guarantee of entry to those wishing to enter would be required). Such a framework would permit a degree of competition between systems of rules and government which would enable, through evolutionary selection, the development of a testing ground for different (exogenous and endogenous) social orders. Such a testing ground would enable the best types of orders and systems of rules to prove themselves and spread their influence, and would clearly lead to the extinction of certain practices. However it would allow for ongoing change in the nature of

social orders and thus would permit the evolution of the rules upon which society depends.

## 2. THE MARKET ORDER

This Chapter will evaluate Hayek's defence of a spontaneous economic order devoid of purposive social goals against demands for the application of constructivist rationalism to economics. This investigation will consist of three stages. Firstly we will consider the 'Socialist Calculation Debate' directed by the 'Austrian' Economists<sup>28</sup> Ludwig Von Mises and Friedrich Hayek, against Marxian economics. We will discuss the nature of this challenge to the Marxists, showing how its central focus was to attack those who wished to do away with pricing, and how the socialists who responded to it were not the target of the criticisms of Hayek and Mises in that debate. We will consider the socialist response to the Austrians, and the Austrians' response to the socialists. It will be concluded, in agreement with Hayek, that the level of knowledge available to a central planner is insufficient to provide for an efficient distribution of resources in the productive process.

Secondly we will consider Hayek's response to those who acknowledge the failure of socialist planning but who advocate 'market wise intervention'<sup>29</sup> in order to correct for market failures. The advocates of 'market wise intervention'<sup>30</sup> will be shown to be attacking a model which falsely represents the capitalist economy, and which Hayek explicitly rejects. The neo-classical framework of analysis will be said to be responsible for much misunderstanding regarding the notion of market failure. The existence of market failure will be acknowledged, but it will be argued that the failure of 'market wise' economists to acknowledge limitations upon knowledge, in their construction of plans for government intervention, undermines the practical value of the policies they suggest. Likewise it will be argued that the intervention suggested to improve the workings of the economy, can, in certain cases, prevent future unforeseen developments which would produce benefits which cannot be predicted.

Finally we will consider Gamble's assertion that Hayek's epistemology is inconsistent with his defence of contemporary capitalism due to the centralised organisational structures which capitalism produces. It will be asserted, in defence of Hayek, that Gamble's argument fails to take full account of the way in which knowledge can be used by the market, and that the benefits of economies of scale can compensate for disadvantages associated with centralised company structures. Further to which it will be noted that centralised management structures are not integral to capitalism, and that the trend in modern corporations is to embrace a market process approach to management which enables improved use of knowledge.

### THE AUSTRIAN CHALLENGE TO MARXIAN AND CLASSICAL ECONOMICS

In his 1920 publication "Economic Calculation in the Socialist Commonwealth" Hayek's mentor Ludwig Von Mises wrote that rational<sup>31</sup> economic calculation was impossible in a socialist commonwealth. Without the use of prices it becomes impossible to allocate resources towards their best use. In claiming that rational calculation was impossible without prices Mises was not claiming, as was assumed, that socialism was impossible; rather that a social system devoid of market based prices would fail to provide the efficient allocation of resources provided by, and needed for, the sustaining of modern civilisation. Mises believed that a society which had made the transition to modernity could not dispense with the institutions of modernity without forfeiting modernity itself.

Value, according to the Austrian school, is a concept which measures only the subjective preferences of individuals, and thus has no objective nature. Nothing has intrinsic value, only value in so far as it is desired. To embrace such a theory of value poses genuine problems for economic calculation unless a measure of subjective value can be found. This measure comes, according to the Austrian school, from the prices people are prepared to pay for a certain good.<sup>32</sup> This is distinct from the objective measuring of value, which calculates value according to objective criteria (such as the amount of labour needed to produce a commodity) to assess the value of the said good. To the Austrian economists, subjective use value is the measure of how much resources are worth putting into the product (as determined by relative desire for the end product), as opposed to the labour theory of value which perceives the labour which has gone into a product to be what determines its value. By allowing individuals to express the relative value they place upon goods, subjective value can be determined.

A further feature of the Austrian school, which was not acknowledged by the socialists, was their rejection of the application of the neo-classical framework of static equilibrium to the understanding of the market. The epistemology of the Austrian school leads them to dismiss the concept of static equilibrium as inadequate to explain markets. Hayek pointed out that a state of equilibrium can only exist when expectations as to the plans of other market participants (e.g. the production and use of many interrelated products) turns out to be exactly as anticipated by the market. Thus static equilibrium assumes perfect knowledge. When knowledge is imperfect the changes in future plans cause a shift in supply or/and demand which causes a disequilibrium. In reality the market economy is constantly subject to changes in plans which means that agents within the market can only seek to form expectations as to future economic activity.

This inability to form accurate predictions renders impossible any attempt regularly to obtain and maintain market equilibrium. Further to which, by assuming perfect knowledge, the neo-classical framework fails to explain the entrepreneurial function which enables adjustments in the price mechanism to come about; one can only explain how adjustments in the price mechanism can occur by reference to the imperfect knowledge which static equilibrium theory chooses to ignore. Entrepreneurialism is based upon an agent being party to information which is not widely known. Without imperfect knowledge the disequilibrium which provides the incentive (i.e. super-normal profits) for entrepreneurial activity cannot exist. According to classical economic theory, when an industry is receiving a normal rate of profit on invested capital, market agents will neither be tempted (in aggregate) to allocate more cash to the market nor be tempted to withdraw cash from the industry; the industry will remain in a state of equilibrium with neither growth nor shrinkage. Super-normal profits are profits at a level which will attract new capital into the industry. Sub-normal profits are profits, at a level below that of the normal rate, which result in a flow of capital from the industry. The neo-classical framework correctly asserts that the production of a new good which is in demand is increased because the super-normal profits which arise when demand outstrips supply causes a flow of capital into the production of the good; the profits then reduce to the normal level as demand and supply match one another, further adjustments in supply occur as demand pushes profits back to super- or sub-normal levels. This analysis of the role of profits, in its effect upon production, can only be explained by reference to entrepreneurialism, which depends upon the market being in disequilibrium. Without the disequilibrium — without a mismatch of supply and demand — super or sub-normal profits would never be attained. So to explain any change in economic activity the neo-classical framework must refer to disequilibrium, and not to the static equilibrium which characterises its

theory. So static equilibrium can only represent an end state of economic activity which assumes that entrepreneurialism is dead, and as such can tell us nothing about the process which produces the end state.

This Austrian insight implies that the multitude of changing factors in a complex economy renders information collected to determine the value of a product (assuming counterfactually that it could ever be collected) likely to be out of date as soon as it has been collected. It is for this reason that Hayek notes that:

... current prices ... serve [only] in this process as indicators of what ought to be done in the present circumstances and have no necessary relation to what has been done in the past to bring the current supply of any particular good on the market.<sup>33</sup>

To this it should be added that current prices fail to serve as an accurate indicator for the future use of commodities. Many factors (supply, demand, subjective value and so on) can change. All economic activity involves risk and anticipation of future changes. While current prices may include information regarding anticipation of future economic activity, this information may be wrong, and only represents our current prediction of the future. So while considerations of the future can impact upon current prices, and thus upon current economic activity, they can still only serve as a guide to current economic activity based upon predictions for the future.

#### **THE RESPONSE FROM THE SOCIALISTS AND HAYEK'S REPLY**

Although Mises' contention with regard to the impossibility of rational calculation in a socialist society was aimed at Marxists (who wished to dispense with markets, prices and money), it was not the Marxists but rather socialists (who wished to keep pricing but have all the means of production, distribution and exchange brought under the control of the state) who responded to his argument. Marxists perceived the claims of Mises to be irrelevant, asserting that

... principles of organization were intimately related to particular modes of historical organization, which were always worked out practically and could only be understood theoretically in retrospect.<sup>34</sup>

The detailed response to Mises came from socialist economists (such as Oscar Lange, H. D. Dickinson, Fred Taylor, and Abba Lerner) who were trained in neo-classical economics but who retained socialist sympathies. They perceived socialism as a system in which the economy was brought under state control, but in which prices, markets and thus money were kept in existence. Lange argued that, even when using a subjective theory of value, rational calculation in a socialist economy was possible. The economy would be run by a central planning board which would establish autonomous enterprises, which would compete with each other to satisfy consumer demand. The central planning board would adjust prices for consumer goods to attain equilibrium. When goods were in short supply it would increase prices to reduce demand and to provide signals to the autonomous government enterprises to increase supply; when surplus were left over the reverse would happen.

This still left the problem of markets in capital goods. If investment were decided by the state there would need to some mechanism for ensuring that capital goods were allocated in accordance with the demands from individuals for consumer goods. Without investment being decided by the state the system could not truly be called socialist. Lange constructed a similar market for capital goods as for consumer goods. The central planning board would decide prices for capital goods, and the autonomous enterprises would respond to these in order to satisfy consumer demand, while acting to minimise costs. By describing how a socialist economy could work Lange was seen to have

won the theoretical debate regarding the possibility of a socialist economy. Lange went on to argue that not only was a socialist economy possible, but that a central planning board would have some information that individual market agents lacked, and would thus be less prone to error. He dismissed suggestions that the millions of equations needing to be solved would prove an insurmountable obstacle by asserting that the same problem of numerous equations faced market agents in a capitalist economy.

The perceived victory of Lange over Mises prompted Hayek to edit *Collectivist Economic Planning* (1935). Hayek raised several points. By focusing on the inadequacies of static equilibrium theory, as a description of what the market does, Hayek was able to highlight problems in the decisions of the central planning agency with regard pricing. The Austrian analysis better represents what occurs in the market, and explains the inability of the markets to reach and maintain equilibrium; it would thus seem that the Austrian analysis is superior to that of the neo-classical school on both practical and theoretical grounds. The solution offered by Lange to Mises' challenge, was based upon the replication of a framework of analysis which both Hayek and Mises explicitly rejected. The model of capitalism which Lange used was a much easier model to duplicate than that adopted by the Austrians, and was a model which does not represent how the market works.

The central thrust of Hayek's response was to deny the possibility of a socialist economy achieving the same level of acquisition and use of knowledge as is achieved in a capitalist economy. Four elements are apparent in Hayek's theory of knowledge. These are: that information is imperfect, decentralised, impossible to collect in any comprehensive manner, and that it is impossible to select with certainty just what information will prove relevant to one's project. These problems affect both central planners and market agents, and prevent both from attaining perfect results; the strength of Hayek's defence of capitalism depends upon the extent to which he can show that knowledge will be better collected and utilised in a capitalist society than in a socialist one.

Hayek considers several factors to suggest that the knowledge problem militates in favour of capitalism. Firstly, and most crucially, individual market agents do not have to respond to as vast an array of information as a central planner does. Determining the price of a product, in the way Lange suggests, requires the planner to accumulate information from across the economy (which, depending upon trading relations, can mean up to the size of the world) regarding the product concerned. The information required includes the scarcity of the product relative to demand and relative to other products which could be substituted for it, the (changing) number of uses to which the product can/will be put, and localised variations in demand together or other factors (e.g. transport costs etc.) which affect the social cost of the use of a product within a locality. One must further remember that the accuracy of this information is crucial to determining what primary products should go into making a secondary product. Miscalculation as to the appropriate price for a product can result in a product being used to make a good when another product would be better used in its place, thus creating a mis-allocation of resources.

In contrast to a central planner, who has to make (after having collected and processed information) an authoritative decision as to the price at which to sell a product, market agents each try to sell their product at a price they select. They receive a reward in proportion to their success at setting a market clearing price and are able to respond to localised and specific information with immediate effect. Of course, as Hayek's opposition to static equilibrium theory suggests, the market can incorrectly set the price for a product and the market can fail to clear as a result. When information or its processing are poor and dise-

equilibrium results (or is likely to result if action is not taken) an incentive is produced in the market for the dispersal of the relevant information by those who are party to it. As Hayek states: “where only a few know of a new fact, the much maligned speculators will see to it that the relevant information will rapidly be spread by an appropriate change of prices.”<sup>35</sup> Such speculators are rewarded for accurately assessing future market activity, and penalised for inaccurately assessing it. Their actions convey small pieces of information through the price mechanism to which producers (who need never know of the underlying cause behind the price change) can respond.

## PROPERTY

Fundamental to any system in which rewards are gained for dispersing diffuse information is the institution of private property, since property rights are the only way to enable individuals who may be party to information to make their contribution to the price of a product and receive the appropriate benefit/loss in proportion to the accuracy of their information. A system which is not based upon property rights has no means of deciding which individuals to take note of when determining what the price of a product should ideally be. Any decisions taken by a process of consultation would be likely to be affected by the relative articulateness of the individuals involved, and would be unlikely to encourage people to spend as much time seeking out information with regard to future economic needs or demands.

A different series of incentives are created by private property rights than are likely to exist under political control. Hayek notes that in the political realm one must act in a manner that one can justify retrospectively, while in the financial realm such justification is not required. The need for retrospective justification has the effect of deterring decisions from being taken which radically depart from what is accepted as prudent practice. It is likely that decisions of a risky nature which promise (if successful) returns which compensate for the risk, are not likely to be taken when under political control. In contrast a private investor, who is party to information which may offer a risky but very attractive return, does not have to provide retrospective justification for a bad judgement (they only have to face financial loss in proportion to their misjudgement), and unlike the state official (whose positive contribution is likely at most to earn him a promotion, but which may be overlooked) he is actually rewarded in proportion to the positive contribution made by the use of his information. This suggests that a private investor will be less disinclined to rational risk taking, or to follow a course of action which departs from traditional economic practice, than a state official is likely to be.

So Hayek views the openness of the market in which incentives are offered for the contribution of, and the acting upon, good information, as being essential to economic prosperity. Hayek stresses that the market has a function as a discovery process which enables information to be tested by the rigours of free competition, and which allows individuals to enter the economic process and act upon the information they possess. Only a system of private property rights, which provides risks and incentives in proportion to the value of their contribution, can provide the open economy upon which the collection and use of knowledge depends.

It could be objected that the dispersal of knowledge cannot be adequately utilised for as long as some individuals do not own, or have access to, the property required to enable their input to the market process. Such an argument could typically be used in favour of the collectivisation of property for the purpose of ensuring that all have an input into its use. This argument could be objected to on at least two interrelated points. Firstly, in a capitalist society, access to property is available to all who can convince a private investor that their idea (such as an idea for a new product) is worthy of investment. While it is true that their

exists no guarantee that an investor will detect the benefit offered by a good idea, the same is true of any state official, and it is not at all clear that good ideas are more likely to be detected by state rather than private investors. Secondly, resources are scarce and need to be allocated in accord with some series of principles. The use of property for one purpose precludes its use for another. Any system can only try the best ideas and cannot expect to try them all. The collectivisation of property only serves to change, and does not serve to increase, the range of ideas which can be acted upon.<sup>36</sup> For reasons given earlier information is less likely to be successfully acquired and utilised by state officials than market agents. Thus capitalism does not produce a utopia in which all can act upon their information, or in which all of the best ideas will be utilised. However it does provide the best framework yet found for the collection and utilisation of knowledge upon which economic activity depends.

## “MARKET PROCESS MANAGEMENT”

Gamble contends that Hayek was right in his opposition to central planning, and quotes James Kornai as conceding that “Looking back after 50 years one can conclude that Hayek was right on every point in the debate ... The hope Lange held out was illusory.”<sup>37</sup> Yet Gamble contends that the “Austrian doctrine of knowledge is double edged”<sup>38</sup> and that it provides an effective critique of contemporary capitalism, which allows the development, and permits the continuation, of large scale corporations. It is Gamble’s assertion that large scale companies are unable to make the best possible use of knowledge, due to their centralised hierarchical structures. Arguing in favour of a decentralised socialism Gamble urges “political action to dismantle concentrations of power, both political and economic, and to distribute power and property as widely as possible”.<sup>39</sup> He states that “Hayek could have followed this course, but his Austrian faith in the invisible hand inclined him to accept as benign whatever evolved spontaneously.”<sup>40</sup> Gamble goes on to ask: “if transnational companies the size of General Motors and IBM are to be accepted, what becomes of Hayek’s insistence on the decentralised character of knowledge?”<sup>41</sup>

In part Gamble’s assertions have been answered. A wide redistribution of resources must be under political control, since private control is contradictory to the continuous process or redistribution necessary to prevent resource accumulation. When resources are under political control, incentives, which are crucial to the acquisition and use of knowledge, are destroyed. Gamble’s assertion as to the contradictory nature of big business and decentralised knowledge is however more interesting. Clearly a monolithic company faces difficulties in obtaining dispersed knowledge, and thus can lack responsiveness to consumer demand as a consequence. Arguments do exist for breaking up companies and for corporate downsizing.

Yet the market provides for the use of knowledge in a second sense which is not accounted for by Gamble. Just as companies possess advantages by being small, similar advantages can exist for increasing the scale of production. These advantages result from economies of scale, and from product recognition made possible by the wide-scale production of goods which carry a guarantee of product quality from which consumers can benefit.<sup>42</sup> These benefits can, for different products, weigh in favour of small or large scale production, and market mechanisms exist to encourage production to tend towards the best level (where the best level is taken as that which most closely matches consumer demand). If a company gets too large to make effective use of knowledge, and if the benefits from its size do not outweigh this, then the resulting poor profits will provide an incentive for investors to transfer their investment to another source offering a greater return on capital. Recent years have seen the growth of market-process management, which by contracting out work, allows companies to improve their use of knowledge

while maintaining the benefits of large scale production and distribution.<sup>43</sup> Gamble's critique of Hayek raises the question of why Hayek himself did not suggest the adoption of market process management. Hayek's defence of contemporary capitalism was never based upon the claim that we have attained an end state to which improvements can not be made. The structure of capitalism has evolved over time<sup>44</sup> with advances in knowledge and changing needs. Hayek did not try to predict future developments in capitalism. Instead he talked of a spontaneous evolution, which is totally compatible with changes in capitalism and changing approaches to management.

### PRINCIPLED REJECTION OF INTERVENTIONISM

The arguments we have considered so far militate against centralised socialism of the type which seeks to replace the market with state control of economic interaction. Hayek's theory of epistemology also provides compelling reasons to be sceptical of 'market wise' socialism which seeks to intervene in the market to correct for market failures. In criticising intervention Hayek is careful to distinguish between intervention which is designed only to uphold the framework upon which he considers the market to be dependent, and intervention designed to achieve certain social goals. The distinction between these two types of intervention lies in Hayek's concept of the market economy. The "catallaxy"<sup>45</sup> of the market is not designed to provide certain social goals, but rather is a spontaneously generated framework in which individuals can interact to achieve their own individual (and often contradictory) goals. Intervention which is designed to achieve social goals creates both 'winners' and 'losers', unlike intervention which aims to uphold the framework of the market, which only enables individuals to pursue their own goals. The creation of 'winners and losers' which the former type of intervention creates, produces the phenomenon of 'concentrated benefits and dispersed costs'.

This phenomenon arises because the benefits of government intervention are normally concentrated in the hands of a relatively small number of recipients, while the costs are widely spread throughout society. It militates against effective analysis of the net effects of intervention, since the benefits of government intervention can be easily detected (with some individuals clearly benefiting from it) while the costs are (due to their diffuse nature) harder to identify and may therefore be underestimated. Miscalculations of benefits and costs may be magnified by the effect of lobbying upon the policy making process. Due to the concentrated nature of the benefits, those who benefit from government policies have a greater incentive than those who lose from them to acquire information about — and mobilise in favour of — certain policies.

It is the bias towards an underestimation of the costs of government intervention with which Hayek is most concerned. He states that "when we decide each issue solely on what appear to be its individual merits, we will always over-estimate the advantages of central direction."; and that "If the choice between freedom and coercion is thus to be treated as a matter of expediency, freedom is bound to be sacrificed in almost every instance."<sup>46</sup> He suggests that the only way to avoid the drift to central direction is to maintain the general rules of society, and to dismiss plans for arbitrary intervention which conflict with those principles on no more ground than the existence of that conflict. Without a principled rejection of interventionism we are likely, says Hayek, to lose the spontaneously generated market order upon which we all depend.

This counter to 'market-wise intervention' may appear dogmatic. To a certain extent it is. But the force of Hayek's argument is that it points to epistemological difficulties regarding the calculation of costs and benefits with government intervention, and to assert that a principled refusal to engage in such planning is the only way to prevent a succession of damaging

interventionary activities. Hayek does not suggest that such intervention could never produce benefits which outweigh costs. To do so would be inconsistent with his epistemology. Interventionary proposals can differ significantly, and a future suggestion for intervention may differ from any espoused today. Hayek's opposition to intervention which is not designed to provide and preserve the framework of the market, but to promote a social goal which produces winners and losers, shows reason for believing that the calculation of costs and benefits could regularly fail to be accurate. Hayek's theory is sceptical of interventionary proposals which may seem to confer real benefits. Other elements within Hayek's thought, which may be directed at socialist central planning, also imply good reason to be opposed to intervention which aims at a social goal. In particular his theory of subjective value demonstrates that the value of goods emanates from, and depends upon, the subjective preferences of individuals. Planning to attain a social goal ignores this pertinent point, since it supposes that agreement upon a hierarchy of goals can be attained, and thus that a degree of objectivity underlies the concept of value. Hayek's account of the market as a catallaxy, in which individuals pursue different, competing, and often contradictory goals, to attain their own satisfaction, demonstrates that social goals with an ordered hierarchy of preferences do not exist. In addition to which, political control of economic life is likely to produce what Hayek sees as the danger of the specialist, in which those with a belief in the desirability of certain social goods will, through the political realm, try to enforce their hierarchy of preferences upon society at large, rather than allow the market place to let each individual to determine the allocation of their resources in accordance with their own hierarchy of preferences.

### 3. LAW VERSUS LEGISLATION

This Chapter will investigate Hayek's distinction between law and legislation together with his preference for the former. It will be shown how Hayek considers law to have developed, its relationship to society, and the function it serves. Hayek's position will be contrasted with legal positivism in these regards. The opposition to legislation will be shown to be grounded in the general epistemological problem which Hayek perceives to be facing society. We will then consider Hayek's defence of some legislative activity to supplement spontaneously generated rules. His justification for legislation will be asserted to be inconsistent with his attack on legal positivism. The solution to the problems which Hayek attributes to judge made law will be shown to exist within his defence of such law. It is to the defence of spontaneously generated law offered by Hayek that this paper will suggest we turn. The defence offered by Hayek of the Common Law will be shown to be historically neglectful of the means by which Common Law developed, and theoretically neglectful of the arguments Hayek uses against monopolies. While undoubtedly preferable to legal positivism, Common Law will not be given unreserved praise. We shall consider how Common Law developed a monopoly position through the development, under royal power, of an 'unequal playing field' between it and other sources of law. The origins of the Common Law will thus be shown to be inconsistent with Hayek's theory of spontaneous order, and to share characteristics in common with the state services which the next section will show Hayek attacking.

#### THE TRUE NATURE OF LAW

The doctrine of legal positivism is, Hayek asserts, wrong both in its factual and normative elements. Legal positivism is factually wrong in that law did not originate in the will of a supreme legislator but rather through the spontaneous growth of custom. It is normatively wrong in that an attempt to construct a social

order through deliberate design, without reference to the spontaneously generated social conventions upon which society depends, will face epistemological problems which would render it a disaster.

Hayek sees the origins of law as existing in the development of customs which produce expectations, for such laws developed prior to any attempt at their enforcement. Hayek speculates that:

... the development of universal rules of conduct did not begin within the organized community of the tribe but rather with the first instance of silent barter when a savage placed some offerings at the boundary of the territory of his tribe in the expectation that a return gift would be made in similar manner.<sup>47</sup>

He goes on to say that:

At any rate it was not through direction by rulers, but through the development of customs upon which expectations of the individuals could be based, that general rules of conduct came to be accepted.<sup>48</sup>

The development of society must be preceded by the recognition of rules of conduct in order for the existence of the society to be possible. The legal positivist notion of law originating when society chooses its rules<sup>49</sup> is logically impossible, since without the prior acceptance of rules society itself could not exist. The existence of rules, being linked to custom, develops in the same manner as does language. Neither are subject to central direction or to a prior plan, yet both can, and must, be widely understood in order to make society possible. The articulation of rules is thus not necessary for their acceptance. “[I]ndividuals had learned to observe (and enforce) rules of conduct long before such rules could be expressed in words.”<sup>50</sup>

The origin of rules has been widely accepted to have developed in this manner until comparatively recent times and the development of the erroneous belief in legal positivism as part of the general development of constructivist rationalism. That law was not created by deliberate construction, but rather discovered, has been the conventional way of viewing law, indeed:

The historians of law are agreed that in this respect all the famous early ‘law givers’, from Ur-Nammu and Hammurabi to Solon, Lykurgus and the authors of the Roman Twelve Tables, did not intend to create new laws but merely to state what law was and had always been.<sup>51</sup>

To explain the role of the lawmaker, and the development of new law, Hayek quotes Fritz Kern, who says:

When a case arises for which no valid law can be adduced, then the lawful men or doomsmen will make new law in the belief that what they are making is good old law. They do not, therefore, create the law: they discover it. Any particular judgement in court, which we regard as a particular inference from a general established legal rule, was to the medieval mind in no way distinguishable from the legislative activity of the community; in both cases a law hidden but already existing is discovered, not created. There is in the Middle Ages, no such thing as the first application of a legal rule. Law is old; new law is a contradiction in terms; for either new law is derived explicitly or implicitly from the old, or it conflicts with the old, in which case it is not lawful. The fundamental idea remains the same; the old law is the true law, and the true law is the old law. According to medieval ideas, therefore, the enactment of new law is not possible at all; and all legislation and legal reform is conceived as the restoration of the good law which has been violated.<sup>52</sup>

Hayek says that “Factual observance of some rules no doubt preceded any deliberate enforcement. The reasons why rules arose must therefore not be confused with the reasons which

made it necessary to enforce them.”<sup>53</sup> The observance of rules is perceived as necessary to give an order to the actions of the society. The observance of rules is fundamental to the creation of an expectation of their observance. It is the creation of the expectation of the observance of rules which Hayek considers gives the rules the sense of justice we accord to them. The role of the judge is to decide what expectations are and are not legitimate, and to resolve conflicts by making judgements as to the legitimacy of expectations in accord with the general principles which govern society.

To understand the nature of the general principles one must first understand the purpose of the law. From Hayek’s account of the origins of law we know he considers law to be indispensable to society. From Hayek’s epistemology we know that society cannot be planned, but that the institutions upon which society depends should serve only to promote and preserve the conditions upon which the spontaneous order depends. It is to provide for a spontaneous order that Hayek writes that:

The aim of the rules of law is merely to prevent as much as possible, by drawing boundaries, the actions of different individuals from interfering with each other; they cannot alone determine, and also therefore cannot be concerned with, what the result for different individuals will be.<sup>54</sup>

So the rules are purpose independent in that they are not designed to bring about any particular outcome, but rather to facilitate individuals in their interactions to achieve their own diverse, and often conflicting, ends. The indifference to individual outcomes is directly comparable with the upholding of conventions cited as the core feature of purpose independent customary law, from which Hayek sees Common Law as evolving. The role of law is compared to that of language, each facilitates interaction and enables individuals to try to achieve their ends, but neither law nor language have a function of achieving any particular ends. Hayek writes of law that of “all the multi-purpose instruments it is probably the one after language which assists the greatest variety of human purposes.”<sup>55</sup>

The law facilitates human interaction by enforcing compliance with the valid customarily acquired expectations which enable the development of a spontaneous order. The law cannot enforce compliance with all expectations since it “would decrease rather than increase certainty if the individuals were prevented from adjusting their plans of action to new facts whenever they became known to them”.<sup>56</sup> So Hayek is asserting that individuals cannot force others to act in a certain way simply to reflect expectations which had been developed regarding their behaviour, unless the expectations have a legitimate basis (legitimacy defined by social convention). This is clarified when he states that:

It is regarded as fully legitimate to switch patronage and thereby disappoint the confident expectations of those with whom one used to deal. The harm that one does to another which the law aims to prevent is thus not harm at all but only the disappointment of such expectations as the law designates as legitimate.<sup>57</sup>

One should add to this that it would not be acceptable to break a contract which committed one to patronage, and that the judge would be expected to force the offending party to pay restitution for such a breach of contract.

In outlining the nature of the general principles, which have governed and should govern human conduct, Hayek mentions anthropological research proving the natural occurrence of property rights in all societies that have so far existed.<sup>58</sup> He states that:

Law, liberty and property are an inseparable trinity ... This was long regarded as self evident and needed no proof ... It has been challenged only in comparatively recent times by

the constructivist approach of socialism and under the influence of the erroneous idea that property had at some stage been 'invented' and that before that there had existed an earlier stage of primitive communism. This is a myth which has now been completely refuted by anthropological research.<sup>59</sup>

In clarifying the role of property he says that:

... the only method yet discovered of defining a range of expectations which will be thus protected, and thereby reducing the mutual interference of people's actions with each other's intentions, is to demarcate for every individual a range of permitted applications by designating (or rather making recognizable by the application of rules to the concrete facts) ranges of objects over which the particular individuals are allowed to dispose and from the control of which all others are excluded.<sup>60</sup>

These functions of law are found to be fulfilled in judge made law; these features can, but will not necessarily, be found in state made legislation. Legislation can fulfil the functions of the law when it is modelled upon judge made law, Hayek regrets that most legislation is not modelled upon such law. The characteristics which legislation must contain in order to achieve the 'purpose' of true law are: an abstract nature which doesn't aim at any concrete outcome, a general nature which makes it apply to all individuals without special exemptions, and an origin in the general principles upon which judge made law is based.

The function served by the judge is to defend legitimate expectations in order to give a regularity to human conduct which enables the preservation, and development, of the unplanned order upon which civilisation is based. Hayek cites the institution of property, in the wide sense as defined by Locke,<sup>61</sup> as fundamental to the orderly action of human conduct. However he acknowledges that the "conception of property certainly did not fall ready made from heaven".<sup>62</sup> The judge has a role in defining what property rights consist of, how they are limited, who they belong to, and what punishment/restitution must be made for their violation. Consistency of judgement is crucial to the preservation of expectations, the law deciding each case with regard to general principles and not with regard to expediency.

In condemning legislation, for tending towards pragmatism rather than principle, Hayek quotes Freund: "The judge addresses himself to standards of consistency, equivalence, predictability, the legislator to fair shares, social utility and equitable distribution."<sup>63</sup> In deciding the nature of property rights the judge will endeavour to be consistent with the principles which have governed society, while trying to improve the demarcation of these rights. When new cases arise, the like of which have not arisen before, the judge will adjudicate in accordance with the principles which have governed past cases. The judge is able to make judgements of cases which have not arisen before since the Common Law "does not consist of particular cases, but of general principles, which are illustrated and explained by those cases".<sup>64</sup>

### **HAYEK'S EXCEPTIONS AND THE CASE AGAINST THEM**

Despite general scepticism towards legislation Hayek does not rule out its legitimate use. Instead he acknowledges a limited but still legitimate role for it. Four reasons are cited in justification of a role for legislation. Firstly:

... law may develop in very undesirable directions, and when this happens correction by deliberate legislation may ... be the only practicable way out. For a variety of reasons the spontaneous growth process may lead to an impasse from which it cannot extricate itself ... or ... at least not quickly enough.<sup>65</sup>

Hayek further observes that the:

... development of case-law is in some respects a sort of one way street: when it has already moved a considerable distance in one direction, it often cannot retrace its steps when some imperfections of earlier decisions are seen to be impracticable.<sup>66</sup>

Secondly, Hayek highlights the gradual nature of change in the Common Law and expresses concern that

... the process of judicial development of law is of necessity gradual and may prove too slow to bring about the desirable rapid adaptation of the law to wholly new circumstances.<sup>67</sup>

Thirdly Hayek notes that the role of the law in guiding and upholding expectations makes changes in the law difficult to execute without prior announcement, such prior announcement can be achieved by legislation which gives forewarning of changes in the law.<sup>68</sup>

The fourth justification is that Common Law may have developed in an inequitable and unjust direction which reflects the interests of the ruling class. In agreement with Marx, Hayek states:

There can be no doubt that in such fields as the law on relations between master and servant, landlord and tenant, creditor and debtor, and in modern times between organized business and its customers the rules have been shaped largely by the view of one of the parties and their particular interests — especially where, as used to be true in the first two of the instances given, it was one of the groups which almost exclusively supplied the judges.<sup>69</sup>

Hayek fails to illustrate any of these four points with examples of particular judicial decisions or examples of Common Law, so it is difficult to address any specific concerns which may underlie his case. The fourth point raised is peculiar both in its assertion that Common Law produces a bias in the conflicts mentioned, and in its implied suggestion that legislation would be likely to be devoid of such bias. Admittedly, Common Law does not acknowledge the validity of all contracts. A contract committing one to slavery, for example, is not considered valid in the law. But it does, for the most part, acknowledge the validity of the vast majority of contracts, the principle function of the law with regard contract having always been to resolve what it is reasonable to assume the contract in question meant. With Common Law, for the most part serving such a function, bias can be resolved by inter party negotiation prior to contractual arrangement. While a socialist could assert that the uneven bargaining power of the parties to the negotiation produces a bias in the outcome of that negotiation, Hayek's opposition to social justice<sup>70</sup> would make it difficult for him to argue the same. Hayek maintains that justice cannot be considered in terms of outcomes, only in terms of rules, making the matter of the relative distribution of resources irrelevant to principles of justice. Likewise the principle of Pareto optimality (which Hayek's broader defence of the market would seem in line with) suggests that contracts which are consented to by both parties, must, so long as neither party is irrational, be to the benefit of both parties. This implies that, while both parties to a contract must expect to benefit from it, any justification of legislation to alter the nature of a contract must rest upon some notion of injustice of outcome — that is, be concerned with unequal benefits arising from unequal bargaining power — and this is inconsistent with Hayek's broader defence of the market and opposition to social justice. Furthermore it is not at all clear how, except in a utopian world where the state acts exactly as we should like, state legislation could be free of bias of the type which Hayek claims to identify in Common Law. If, as Hayek maintains, judges adjudicate in terms of principles, while legislators tend to decide in terms of expediency, then it is clear that

the latter have much more room for making biased decisions. Public choice theory<sup>71</sup> offers further compelling reasons for doubting the impartiality of state decisions. The political process is open to inputs from many groups and individuals seeking special treatment under the law, organised groups are liable to achieve more influence in changing legislation than the politically less well organised, it would therefore seem that legislation would be more prone to bias in favour of class interests than the Common Law (as Hayek describes it) is likely to be.

The three other points raised by Hayek are more interesting and contain a grain of truth, but they are still inconsistent with many of the arguments marshalled against legislation. It is not clear what Hayek is referring to when he states that Common Law may develop in unfavourable directions, although a few examples could be seen to be consistent with this argument. It would seem that Hayek is suggesting that the conception of property and contract may have developed in such a way that it is now found to be unjust or morally abhorrent, but which historically (over the period of its development) was seen as just. An example of this would include the refusal of the Common Law, until recent times, to acknowledge the possibility of rape within marriage, believing that the marriage vows represent a contract to engage in intercourse. Yet the overturning of this law by judicial decision demonstrates the ability of the law to extricate itself from such a 'one way street'. While it is true that such a change in law was initiated by prior changes of public opinion, and could therefore (like legislation) be labelled 'political'; this still serves to demonstrate that Common Law does not dig itself into holes from which there is no escape, and that the conception of rights and contract can be reversed when widely perceived to have been wrong.

#### **HAYEK'S INCONSISTENT DEFENCE OF COMMON LAW**

Changes in the Common Law with regard to marital rape could, however, be seen to uphold two further objections which Hayek makes to the Common Law, namely that change in the law is slow in nature, and that retrospective judgements can be inherent to any changes in the law made. While one may have little natural sympathy for a man who committed this offence at a time when the act was not prohibited, and who was punished with retrospective legislation, one might be very concerned with other cases where it might occur. Still, in the case we considered it was evident that the culture had changed and that society did regard marital rape as immoral, when judicial decisions change it is (and without central direction must be) because of a change in 'grass roots' attitudes; these attitudes can be detected by individuals as well as by the judiciary and legislatures. While the principle of property remains the guiding principle of the judiciary, it is evident that retrospective judicial decisions can only adversely affect those operations at or beyond the boundaries of what is widely regarded as acceptable. While it is true that legislation, well directed and limited, can confer some benefits in this regard, it is less evident that we need be too concerned with the few cases in which retrospective decisions are taken. Indeed Hayek, when attacking legislation and defending judge made law, makes several statements which are inconsistent with this justification for legislation. When criticising the legal positivist notion that all law should have prior announcement, he states that:

... even John Locke's contention that in a free society all law must be 'promulgated' or 'announced' beforehand would seem to be a product of the constructivist idea of all law as being deliberately made. It is erroneous in the implication that by confining a judge to the application of already articulated rules we will increase the predictability of his decisions. What has been promulgated or announced beforehand will often be only a very imperfect formulation

of the principles which people can better honour in action than in words. Only if he believes that all law is an expression of the will of a legislator and has been invented by him, rather than as an expression of a going order, does it seem that the previous announcement is an indispensable condition of knowledge of the law.<sup>72</sup>

In making such a statement Hayek is clearly suggesting that the principles which underlie the law are what gives it its basis, and the prior announcement of every law which may arise from these principles is neither necessary nor possible. Indeed Hayek compares the principles which underlie the law to those which underlie the notion of 'fair play'; it is impossible to definitively list all that is prohibited by either notion, but it is clear when they are breached.

The role Hayek allocates to the legislature, of formulating law in accordance with the general principles, must rest upon it knowing the nature of what is required by these principles. It is no more likely that it will be able to adjudicate on these principles than the judges. While a legislature can offer some benefit in terms of prior announcement, it is difficult to envisage many times when such prior announcement could not be served, for judicial change, by the general change in societies attitude towards property rights and their demarcation. For those who are operating in areas where property rights are uncertain, and who fear from the uncertainty of judicial judgement, explicit contracts prior to action/interaction could remove (depending upon the nature of the contract and legal recognition of it) any danger from retrospective judgement. Such contract should, generally, be recognised in Common Law since an underlying principle of the law has traditionally been the recognition of property rights and thus of consensual contracts.

While clearly preferable to legislation, Hayek's defence of Common Law lacks consistency both with his theory of spontaneous order and with his general scepticism towards monopolies. The polycentric legal system<sup>73</sup> which characterised medieval England was undermined, and eventually destroyed by the anti-competitive practices of the monarchy, the nature of which practices Hayek himself condemns when referring to the acquisition of monopoly status for many contemporary state services. The medieval legal system permitted many overlapping jurisdictions which provided competition between courts for the provision of legal services. Explaining the function of competition between jurisdictions Berman writes that:

A serf may run to the town court for protection against his master. A vassal might run to the king's court for protection against his lord. A cleric might run to the ecclesiastical court for protection against the king.<sup>74</sup>

Bell writes of such medieval legal systems that:

The same person, in different capacities ... enjoyed a significant degree of choice among legal systems, forcing them to compete.<sup>75</sup>

Royal law came to predominate over other legal systems for two important reasons. Firstly, its ability to raise taxes allowed it to subsidise its legal services, and thus to provide them at below market rates. "Royal courts absorbed the local functions of the law merchant ... by adopting its precedents and offering to enforce them at bargain rates."<sup>76</sup> Secondly, royal law possessed "far greater coercive power than competing legal systems, which depended upon reciprocity and trust for their operation".<sup>77</sup> After establishing a monopoly of legal provision the new royal law reclassified crimes as being against the state, rather than against the individual. This enabled it to give the fines for crimes such as murder and rape to the king rather than to the victim or their family as had traditionally been the case. Victims were only given the pleasure of seeing the criminal suffer corporal punishment. "Dissatisfied individuals continued to

seek restitution out of court, so state officials forbade them to take justice into their own hands.”<sup>78</sup>

What is clear from the development of the monopoly of royal law is that the demise of private legal systems was initiated by, and dependent upon, uncompetitive state practice. Hayek does not address the historical detail of the rise of the Common Law, and thus does not provide arguments in favour of it as opposed to the polycentric system it replaced. It would seem from the arguments marshalled by Hayek against the monopolistic provision of other state services, and in favour of the spontaneous development of social institutions, that Hayek should advocate a modern polycentric legal system. While it is possible to formulate arguments against such systems of law Hayek fails to do this.

The most Hayekian argument Hayek could have used in favour of monopolistic state law, would be to assert that a monopoly of law will naturally occur due to benefits which it brings. If true this argument could be seen to favour the Common Law. However while such law did not arise from spontaneous market processes which favoured monopoly power; but rather from to state monopolising action (the like of which Hayek frequently attacks) such an argument is by no means proven.

#### 4. PUBLIC POLICY IN THE HAYEKIAN STATE

This final section will consider Hayek’s assessment of the limits of market rationality and the scope for government action, with respect to the justification he employs in favour of government intervention and provision of services.

First we will look at the notion of externalities, which Hayek thinks make certain services ‘inexcludable’ and thus requires a role for government in their funding. Second we will look at the idea that the dislocation of individuals from their traditional communities, caused by economic progress, necessitates a role for government in ensuring welfare provision so as to provide for those unable to provide for themselves and to prevent a backlash against economic modernisation. Thirdly we will examine the approach Hayek thinks government should take towards monopolies. Finally we will examine the way in which the necessary taxation should, according to Hayek, be raised. By examining Hayek’s approach to public policy we shall explicate and evaluate his notions of market imperfection, and consider how government action can or cannot seek to rectify these problems.

##### INEXCLUDABLE SERVICES

In addition to providing the minimal functions necessary for the maintenance of law, order, and property, Hayek believes that the modern western state is able to, and should, provide a number of supplementary services which, while to the advantage of all its citizens, cannot be provided by the market alone. He states that:

Certain services ... can be provided only for all (or at least will be provided more cheaply and efficiently only if they are provided for all<sup>79</sup>). To this category belong not only such obvious instances such as protection against floods or avalanches but also many of the amenities which make modern life in cities tolerable, most roads (except some long distance highways where tolls can be charged), the provision of standards of measure, and many kinds of information ranging from land registers, maps, and statistics to the certification of the quality of some goods or services offered in the market. In many of these instances the rendering of such services could be no gain to those who do so, and they will therefore not be provided by the market.

These are the collective or public goods proper, for the provision of which it may be necessary to devise some method other than that of sale to individual users.<sup>80</sup>

This is not the case for all societies. In some underdeveloped societies a state should provide no more than the minimal functions, “since an additional burden would exceed its weak powers and the effect of attempting more would be that it did not even provide the indispensable conditions for the functioning of a free society”.<sup>81</sup> “Such considerations are not relevant ... to advanced western societies”,<sup>82</sup> where the government is able to provide such services without compromising the indispensable services, and where society can support the government which exceeds these minimal functions. So, according to Hayek, the responsibilities of government can grow and evolve with its ability to meet the needs of new services. It is in the nature of Hayek’s spontaneous order theory that no rigid classification of what government should do can be made precisely because this depends upon many factors which change, and which cannot be predicted.

Such are the advantages of these additional services that they alone provide sufficient justification for the state:

Indeed it could be maintained that even if there were no other need for coercion, because everybody voluntarily obeyed the traditional rules of just conduct, there would still exist an overwhelming case for giving territorial authorities power to make the inhabitants contribute to a common fund from which services could be financed.<sup>83</sup>

Provision of such services is justified by reference to the interest of all individuals. This does not imply that each individual need benefit from the provision of each service, but only that they benefit from the provision of the services overall.<sup>84</sup> In justifying each individual contributing to provide some services which they do not want Hayek invokes the notion of a “common pool” from which “each may expect to get services which are worth more to him than he is made to contribute” thus making it “in his interest to submit to the coercion”.<sup>85</sup>

The provision of these services should, where possible, be conducted by local rather than national government, since “the delegation of all powers that can be exercised locally to agencies whose powers are confined to the locality is probably the best way of securing that the burdens and the benefits from government action will be approximately proportional”.<sup>86</sup> Local government is more responsive to the diverse needs of society, and is better able to determine equitably the balance of services provided out of the “common pool” so that the benefit each receives will be proportional to one’s contribution.

Hayek goes on to add that:

... the fact that some services must be financed by compulsory levies by no means implies that such services should also be administered by government. Once the problem of finance is solved, it will often be the more efficient method to leave the organization and management of such services to competitive enterprise.<sup>87</sup>

And that:

Even if in given circumstances only government is in fact able to supply particular services, there is no reason for prohibiting private agencies from trying to find methods of providing these services without the use of coercive power. It is even important that the manner in which government provides such services should not be such that it makes it impossible for others to provide them.<sup>88</sup>

The term “coercive power” refers to the taxation used to finance the public funding. While the use of coercion in this sense applies also to the funding for service provided by competitive tendering it becomes clear that Hayek is making clear his preference for private rather than governmental demand for market

services. The government should not prohibit competition with its services by private companies who wish to compete with the service offered.<sup>89</sup> Likewise it is clear that Hayek is concerned that the provision, or funding, of services by government may prevent their funding/provision by other means. To prevent such a situation developing it may be suitable for government, where possible, to impose the costs of the service upon the beneficiary. Of course where goods/services are inexcludable this is, by definition, impossible to achieve; where future developments make goods/services excludable they should, by Hayek's theory, be provided by the market anyway. It is therefore difficult to see how government can provide inexcludable service in a manner which doesn't preclude others from providing them in the future.

When new technological developments make an inexcludable good excludable, the government can, and according to Hayek, should, use pricing for the good/service, so as to prevent market agents from being excluded from entering the market. It could be pointed out that when excludability becomes possible that rationale offered by Hayek for government provision disappears and that the government should not be providing it at all; and so the very question of government charging for its services is incompatible with the justification of government services as offered by Hayek. However by providing a newly excludable service, at its full cost, until the capacity of the market has developed to the point of being able to provide it, the provision of a service can continue until the market has grown to be able to satisfy consumer demand. Thus there does exist some logic behind government provision (for a limited time) of excludable services so long as the full cost is passed onto the consumer, in order to allow a gentle transition to market provision.

Related to the notion of inexcludable goods is the notion of externalities, both positive and negative, which exist when the effects of one's activity or potential activity cannot be confined to one's property. Although Hayek doesn't precisely spell out how these are to be dealt with it is clear that he considers that they could justify some government action to supplement Common Law rulings. In particular positive externalities<sup>90</sup> may be corrected for by providing, from the public purse, for a financial subsidy for the person providing the positive externality. By rewarding the person for the unpaid value of their action to society the inability of the market to provide such payment is corrected for. This is what Hayek means when he writes that "subsidies are a legitimate tool of public policy, not as a means of income redistribution, but only as a means of using the market to provide services which cannot be confined to [individuals]."<sup>91</sup> He goes on to say that "[s]ubsidies can never be justified in terms of the interest of the immediate beneficiary ... but only in terms of the general benefits which must be enjoyed by all citizens."<sup>92</sup>

This advocacy of intervention in the market place sits uneasily with Hayek's plea (as noted in Chapter 2) for a principled rejection of intervention on no other grounds than the conflict between intervention and the general principles upon which society is based. We must therefore assume that the use of subsidies must be exceptional, and must certainly not justify any attempt to correct for every positive externality. Such an undertaking would be impossible, requiring payments to every gardener who planted a flower which may be viewed by a passer by. Hayek's epistemology shows that an undertaking to correct for all externalities would prove impossible to attain. Used in very exceptional cases it could be true that subsidies can serve a function to provide valuable services which would not otherwise be profitable,<sup>93</sup> but any regular use of them to improve on the market could soon drift towards the constructivism which Hayek deplors.

## GOVERNMENT AS GUARANTOR AND FACILITATOR OF WELFARE

A further argument for state activity exists within Hayek's approach to public policy which advocates funding of social welfare to be provided by the public purse. According to Hayek the mobility of advanced society destroys ties of kinship and thereby leads to an increasing number of people who "are no longer closely associated with particular groups whose help and support they can count upon in case of misfortune".<sup>94</sup>

He says that:

The problem here is chiefly the fate of those who for various reasons cannot make their living in the market, such as the sick, the old, the physically or mentally defective, the widows and orphans — that is all people suffering from adverse conditions which may affect anyone and against which most individuals cannot alone make adequate provision but in a society that has reached a certain level of wealth can afford to provide for all.<sup>95</sup>

He goes on to state that:

A system which aims at tempting large numbers of people to leave the relative security which the membership in the small group has given would probably soon produce great discontent and violent reaction when those who have first enjoyed the benefits find themselves without help when, through no fault of their own, their capacity to earn a living ceases.<sup>96</sup>

In order to secure an adequate provision for all, which prevents the development of the discontent with the society which produced the increased social mobility, Hayek proposes a "uniform minimum for all who cannot provide for themselves".<sup>97</sup> He goes on to lament how unfortunate it is that this has become confused with the notion of a just distribution and social justice.<sup>98</sup>

The level of welfare provided is not to be minimal, and it is accepted that some who could have made provision for themselves will stand to benefit. Hayek says of social security that:

It is probably inevitable that this relief will not be confined to those who themselves have not been able to provide against such needs ... and that the amount of relief now given in a comparatively wealthy society should be more than is absolutely necessary to stay alive and in health. We must also expect that the availability of this assistance will induce some to neglect such provision against emergencies as they would have been able to make on their own.<sup>99</sup>

And that:

It can hardly be denied that, as we grow richer, that minimum of sustenance which the community has always provided for those not able to look after themselves, and which can be provided outside the market, will gradually rise, or that government may, usefully and without doing any harm, assist or even lead in such endeavours.<sup>100</sup>

None of this is to imply that government should possess a monopoly over provision or funding of these services, nor even accept primary responsibility for them. The role of government is to act as a guarantor and facilitator of welfare. It can do this in more market friendly ways than is the case with current practice. While Hayek fails to spell out a programme for welfare policy<sup>101</sup> it is clear that the private sector is intended to assume a major role. This is indicated in his support of private insurance against personal misfortune which, Hayek believes, should be made compulsory to prevent the individual from becoming a burden on the public.<sup>102</sup>

In discussing healthcare he states that the case for a free health service is "usually based on two fundamental misconceptions". These are firstly: "the belief that medical needs are usually of an

objectively ascertainable character and as such that they can and ought to be fully met in every case without regard to economic considerations” and secondly “that this is economically possible because an improved medical service normally results in a restoration of economic effectiveness or earning power and so pays for itself.”<sup>103</sup> The first consideration is wrong, since health, like all else only has subjective value. Even “the richest man will normally not do all that medical knowledge makes possible to preserve his health, perhaps because other concerns compete for his time and energy.”<sup>104</sup> Those with less financial resources should, it seems implied, be free to balance health against other concerns and to allocate resources accordingly. This is consistent with Hayek’s notion of subjective valuation of resources which forms an integral part of his economic theory as advanced in Chapter 2. The second misconception is wrong since only some kinds of healthcare promote economic efficiency, and, with endless expenditure on health possible, some rationing must take place. If we do not allow subjective valuation to ration health care by placing the costs of the healthcare onto those who benefit from it (through health insurance etc.) then another rationing mechanism must be found. This is currently exercised through the institution of the waiting list, which disproportionately impacts upon the old who are less likely to live to receive their operation.<sup>105</sup>

Although it is not clearly spelt out it would seem from Hayek’s insistence upon compulsory health insurance, and from his espousal of the notion of subjective valuation in relation to healthcare, that he would desire compulsory health insurance against a certain basket of risks to one’s health with freedom to extend that insurance to cover other risks also. It would also seem evident that his minimum income suggestion for social security would be sufficient to pay for private health insurance.

One can acknowledge that this represents a considerable improvement upon current policy in that it allows each individual to supplement his current health expenditure without having to replace it altogether as one currently has to do.<sup>106</sup> But problems do exist within the idea of compulsory insurance, which arise from its compulsory nature, and which bring the idea into conflict with principles central to Hayek’s economics.

The notion of compulsory health insurance presupposes an objective value to certain aspects of health, yet Hayek asserts that value is subjective, and argues against universal healthcare on the grounds of this subjectivity. If health is a subjective value then it is improper for the state to enforce minimum levels of health insurance upon those who may not want it enough to warrant its cost. The notion of subjective value, which Hayek’s Austrian economics is in part based upon, is inconsistent with the objective criteria which compulsory health insurance is based on. A subjective theory of value does not necessarily militate against any public provision, nor even against welfare payments as outlined in Hayek’s minimum income plan. Public provision of inexcludable goods which are subjectively valued by the population at large could be justified by the assertion that they would not otherwise be provided (e.g. public goods). The minimum income plan does not presuppose objective value so long as it is based upon the desire to preserve the framework of society, and for as long as it leaves the individuals to spend the income in accord with their subjective preferences.<sup>107</sup> Healthcare is not a public good from which the benefits are inexcludable, and therefore state enforced minimum levels of healthcare insurance provision cannot be justified without reference to objective value.

Several dangers are inherent to this argument in favour of compulsory insurance. Firstly, if the government accepts liability for misfortune irrespective of personal irresponsibility, and is permitted to regulate human conduct in order to prevent expense to the public purse, then an erosion of civil liberties becomes inevitable. Not making adequate provision against personal risk

is, when the state accepts such liability, a potential burden on the public purse, so are many recreational activities which contain an element of personal danger. When life is collectivised, through the attributing of responsibility for human misfortune onto society, then it is inevitable that society will progressively spread its sphere of influence to reduce its financial burden.<sup>108</sup> This leads down the road to serfdom of which Hayek warns.

The assumption, by society, of responsibility for an individual’s misfortune, whether undeserved or deserved, should never have been made. Hayek assumes that such public provision is necessary due to the increased mobility of society which destroys kinship ties; yet, despite the tax and welfare policies which discriminate against it,<sup>109</sup> the most important tie of kinship, the family, still exists today, and would (even in its current form) prove able to provide considerable support. The family is not a sufficient institution to provide against all misfortune, and historically secondary institutions (the church, philanthropy, and friendly societies etc.) have provided for the needy when self help and the unit of the family have failed. The growth of state welfare preceded, and caused, the destruction or downgrading of many secondary institutions, and the religious base upon which they depended, which provided adequate welfare support. It seems unthinkable, from the perspective of a contemporary welfare society, that such generosity could exist, but in the 1870’s the typical middle class family voluntarily gave an average of 10% of its income to charitable causes, while most married middle class women would do at least one and sometimes two days of charity work each week. To suggest, as Hayek does, that the growth of state welfare was a spontaneous process required by changing historical circumstance is to ignore the historical development of such policies, which were supported by interest groups, and often treated with distrust by the working class. This was clearly the case with the early development of state healthcare, which was initiated by successful lobbying by doctors who, after a failed attempt to construct a cartel in Preston, managed to obtain a professional monopoly for their services with a minimum legal fee to be paid to them.<sup>110</sup>

## TRADE UNION AND OTHER MONOPOLIES

When addressing the issue of monopolies Hayek makes the distinction between monopolies which are damaging to society, and those which are not. A monopoly which is maintained due to the superior service or/and reduced price permitted by economies of scale is not detrimental to society. A monopoly which is maintainable because barriers to entry prohibit competition can become damaging to society, because the absence of market pressures can allow it to deliver poor quality service at an inflated price. So by this classification a village bakery, without effective competition due to poor transport links, would be likely (if barriers to entry were not created) to be a non-damaging monopoly. A bakery which offered bad service at a high price would lose customer loyalty and would be inviting a competitor to enter the market who could take all its business.

Barriers to entry normally emanate from government legislation or subsidies designed (implicitly or explicitly) to prevent competition.<sup>111</sup> This type of monopoly power can be removed by changing government policy to make it conducive to competition, by removing legislation which prohibits competition, and by allowing government funded services to be provided by market agents. (Hayek supports Milton Friedman’s idea of education vouchers to achieve such competition.) A further type of barrier to entry can be created by price manipulation designed, by private companies exercising monopoly or near monopoly power, to undermine any competition which may challenge it.

The most damaging monopoly power exercised at the time of his writing, was perceived by Hayek to be the power of the unions. Hayek writes of their power that:

It cannot be stressed enough that the coercion which unions have been permitted to exercise contrary to all principle of freedom under the law is primarily the coercion of fellow workers. Whatever true coercive power unions may be able to wield over employers is a consequence of the primary power of coercing other workers; the coercion of employers would lose most of its objectionable character if unions were deprived of this power to exact unwilling support.<sup>112</sup>

The coercion of fellow workers emanates (according to Hayek) from closed shop agreements which require union membership as a condition of employment. The coercion of employers to provide increased wages for the union members is detrimental to society, since the price of labour can only be increased ahead of productivity gains by a reduction in employment. Hayek suggests that the monopoly power exercised by unions, and any companies which engage in price fixing, should be corrected by making all agreements in restraint of trade unenforceable in law. It is an oft-criticised deficiency of Hayek's thought that he makes no clear definition of an agreement in restraint of trade, although it would apply to cartels, closed and union shop agreements. Hayek further proposes that potential competitors should be able to sue those who manipulate prices. He sees this as superior to allowing government to have control, as potential competitors are more aware of market conditions.

Several problems exist in Hayek's suggestions to prevent destructive monopolies. Firstly when a monopoly does exist, it isn't clear who potential competitors are. Theoretically any individual could be a competitor. To require that one must attempt to establish a company in competition with the monopoly in order to entitle one to sue would seem just as unworkable as allowing anyone to sue, since, depending on the level and certainty of compensation, companies may make an attempt at competition purely to receive compensation, or genuine potential competitors may not attempt to enter the market at all if compensation is inadequate. Either way the process of deciding on compensation would entail difficult courtroom decisions which might suffer due to inadequacy of information. A further problem would arise in deciding at what, if any, stage in the proceedings sensitive commercial information would be made public. (We hardly need dwell on the difficulties of proceedings in which such information was not made public, nor on the potential adverse affect upon commercial activity if companies need be concerned with such breaches of confidentiality.)

A second problem is that Hayek misidentifies the true source of union power. It does not emanate from closed shop agreements, but from the illegality of making employment conditional upon one not being a union member. Without this legal restriction the unions could never have gained the power to enforce closed shop agreements on unwilling employers. The closed shop agreement is the result of a negotiation in which one party, the union, had developed a strength, which it could not otherwise have done without state legislation. In seeking to ban the closed shop Hayek breaks with the general principle of free association and thus subordinates principle to expediency. All that need have been done to rectify trade union power is to support the principle of free association with regard the conditions for obtaining employment and the problem of overly strong trade unions would not have arisen.

Thirdly, in suggesting that price fixing must be punishable by law Hayek is falling into the mistaken belief that such practices can ever be rational, or can sustain a monopoly position. By dropping prices below the market level in order to prevent competition (even if only in one product in the range of a conglomerate, or in one region of its business activity) a company must accept lower profits or even a loss until it has regained monopoly position due to its opponents collapse. Reduced profits, or a loss, can only be sustained for a limited period unless capital is to flow out of the company and cause its collapse. Even if it

can be done for long enough to 'kill off' one competitor such a practice does nothing to prevent future competition, and having pursued such a policy one is less able to resist — and more vulnerable to — future competitors. Hence the market over which a firm has a monopoly offers a lucrative target for entrepreneurs.<sup>113</sup>

These facts are supplemented by the desire of the consumer not to fall prey to a destructive monopoly which inflicts bad service at a high price. Friedman<sup>114</sup> points out that, when the number of customers is sufficiently small to be identifiable, it can be in the interest of the consumer to contract with an entrepreneur to buy his product for a fixed period of time at a rate lower than that currently offered by the monopoly power, and to decline any short term enticements the monopoly power may offer in order to extinguish competition. It need not be the case that all customers agree to purchase the product from the entrepreneur so long as there are enough to provide a market sufficient to make his undertaking viable. Such a contract gives a safe market to the entrepreneur and cheaper goods for the consumer, allowing the entrepreneur to establish his business with a guaranteed market for his produce while allowing the consumer to save on the deal they would be offered if not for the entrepreneur.

Finally it is the case that cartels cannot be successful, since there is, in addition to the temptation for entrepreneurs to enter the market and the means for them to do so (as outlined above), also an inherent desire to defect on the agreement in order to maximise individual benefit. Even when the cartel can maintain itself in terms of price (which is easily quantifiable among cartel members), it is almost impossible to hold together an effective cartel due to competition surrounding the increased quality of the merchandise. Market agents in a cartel may wish the price to remain high, but they also want their share of the market to be as large as possible. The way to benefit optimally from a cartel is to offer a slightly better deal than ones opponents while your opponent holds to the spirit (and not just the word of the cartel agreement). When price is easily quantifiable (and so can't be reduced without risking reciprocal action by cartel members) the way to outperform one's opponents is to increase the desirability of one's product in order to attract more custom. Enticements such as higher quality, improved packaging, increased advertising or free entry to big prize competitions etc. can entice more custom. We should also remember that most goods suffer from a dip in demand as price increases generating a need for increased profit per unit sold just to maintain a stable profit level overall. This all suggests that an established cartel would, even if it were to manage to hold off external competition and maintain adherence to predetermined prices, suffer from an inherent tendency to squander the increased profits created upon enticements to attract consumers to their product. Any extra profits the cartel may initially generate would be likely to be squandered as each party to the agreement competes in non-price terms to gain more custom, thus no long term benefit from the cartel can be attained for its members.

## TAXATION

The tax burden should, overall, be proportional to income according to Hayek. Hayek quotes from Thiers in saying that "proportionality is a principle, but progression is simply hateful arbitrariness" and from Mill in saying that progression is "a mild form of robbery".<sup>115</sup> Hayek lists several problems with progressive taxation: (i) it doesn't provide any significant revenue, (ii) in not being a general principle it "indicates no halting point for its own application",<sup>116</sup> (iii) it is unfair, and (iv) it distorts the market. In suggesting that progression indicates no halting point for its own application Hayek further adds that the "good judgement of the people"<sup>117</sup> offers no safeguard against ever increasing rates and goes on to say that:

Personally I do not believe that setting an upper limit which progression is not to exceed would achieve its purpose. Such a percentage figure would be as arbitrary as the figure of progression and would be as readily altered when the need for additional revenue seemed to require it.<sup>118</sup>

In demonstrating the tendency for such progressive taxes to rise he points to British and American tax regimes which were introduced in 1910 and 1913, with the top rate of tax rising to 8.25 and 7 percent respectively. Within thirty years these had risen to 97.5 and 91 percent.<sup>119</sup> In demonstrating that such progression raises little revenue he says that the contribution made by progression in these two countries is between 2.5 and 8.5 percent of total revenue.<sup>120</sup> In fact this is likely to be a gross over-estimate, since experience in these two countries following subsequent cuts in the higher rate of tax has shown these cuts to produce an increase in revenue (although it would seem that the optimum tax for in terms of short term revenue collection is still a level higher than that of basic rate tax).

Hayek considers that a fair tax structure would raise revenues from each individual in proportion to their earnings. Progression can only be justified, he asserts, in order to offset the regressive impact of indirect taxation, but the tax regime should be proportional overall. This claim makes Hayek's consideration of proportionality in terms of top rates of tax less than totally relevant, since these rates, in themselves, tell us little about the overall burdens of the tax structure.

Progressive taxation distorts the market since it weighs heaviest on those whose earnings are concentrated into a relatively small number of years. Hayek goes on to state that "No practical scheme of averaging incomes can do justice to the inventor, the artist or actor, who reaps the rewards of perhaps decades of effort in a few years."<sup>121</sup> Furthermore he states that it should not "be necessary to elaborate further on the effects of steeply progressive taxation on the willingness to undertake risky capital investments."<sup>122</sup>

In assessing the tax system Hayek asserts that the "whole practice of public finance has been developed in an endeavour to outwit the taxpayer and to induce him to pay more than he is aware of"<sup>123</sup> and that "what should have been the main consideration, namely [that] raising the means should operate as a check on expenditure has been little considered".<sup>124</sup> By implication Hayek is calling for a highly transparent tax system, which shows the taxpayer what they are paying and hence what public expenditure costs them. Although he does not mention this tax, this aim could be achieved from a consumption tax which expected from each taxpayer an annual cheque for a fixed proportion of their expenditure (calculated by deducting their savings from their income); the transparency of such a tax may help dampen calls for ever higher expenditure.<sup>125</sup>

Hayek's analysis of taxation is perceptive and largely correct. However the principle of proportionality can be no more than a 'rule of thumb' which is generally best adhered to, and it may not even be that. He justifies this principle by claiming that one's consumption of government services rises roughly in proportion to income. Yet this claim is highly dependent on what it is that government provides, and on many other factors. While it is the case that a rich man will tend to consume more from government (owns more property which needs protection, more likely to use libraries, art galleries, and publicly provided parks) it is not clear that a tenfold increase in income will lead to a tenfold increase in one's consumption of these services, indeed it seems unlikely. Furthermore when government provides welfare (healthcare and social security) it would seem that the poor may use almost as much, if not more than, the rich. (This is contested as the relative articulateness of the middle and upper class provide them with an advantage for extracting more from government.) Certainly a rich man does not consume welfare

benefits in proportion to his earnings. It would seem that the notion of the 'common pool' from which we acquire goods in rough proportion to our contributions (the justification offered by Hayek for government expenditure) could be betrayed by proportional tax, and may be better served by a regressive tax, although not so regressive as a fixed sum tax (i.e. a tax which required an equal cash payment from each taxpayer).

However it is doubtful whether any tax could collect revenue in proportion to consumption of government services, and one would suspect that Hayek would agree that whatever the tax system, it is fairer to provide goods and services, as far as this is possible, with market pricing for their consumption.

## CONCLUSION

Hayek is correct to assert the theoretical inaccuracy of constructivist rationalism as a description of the origins of law and social institutions. Epistemological constraints militate against effective central economic planning. 'Market wise' intervention, currently suggested as an alternative to free market capitalism, and to command style socialism, is similarly militated against by epistemological constraints. Knowledge is imperfectly used in a capitalist society but, as Hayek's theory of evolution suggests, spontaneous changes in the nature of capitalism improve the way in which knowledge is used.

Hayek's defence of spontaneous order rests upon the notion of evolutionary selection which enables a higher levels of inter-generational transmission of good rules than of bad rules. Such selection is not fully compatible with large scale political organisations which are able to suppress developments which challenge their existence. Such evolutionary selection is better achieved through a decentralised order in which many competing (almost autonomous) political units can exist. A central framework would need to exist for external defence and to guarantee freedom of exit from any political unit.

The reliance of judge made law upon general principles makes it superior to legal positivism, which is premised upon the central direction of law to achieve purposive direction. Hayek's critique of legal positivism, as factually inaccurate and normatively undesirable, is correct. The arguments used by Hayek against legal positivism conflict with those used in favour of a limited role for legislation. Common Law is not as spontaneous as Hayek suggests, but is instead the result of state monopolising action the like of which Hayek attacks when referring to contemporary state activity. A defence of spontaneous law would suggest a return to polycentric law.

Hayek's epistemology, defence of spontaneous order, and opposition to monopolies is incompatible with many of his suggestions for public policy. Hayek's suggestions for the prevention of commercial monopolies are unworkable and unnecessary. The suggestion for the banning of closed shop agreements between unions and employers is a violation of the general principle of freedom of contract, inspired by expediency, and a misidentification of the true source of union power. The collective provision of goods may on occasion be necessary, and can be fulfilled by the decentralised liberal 'metautopia' suggested. However welfare provision is neither necessary nor desirable, and can lead to the collectivisation of economic life which, as Hayek warns, leads to serfdom.

Hayek's critique of constructivism is effective in its demolition of a flawed social theory, but the arguments upon which that critique depends suggest different conclusions to those which he acknowledges.

## NOTES

1. Hayek, F. A., *Law, Legislation and Liberty: Volume 1, Rules and Order*, Routledge, London, 1973, p. 36.
2. *Ibid.*, p. 36.
3. *Ibid.*, p. 20.
4. Ferguson, A., *An Essay on the History of Civil Society*, London, 1767, as cited by Hayek, *ibid.*, p. 20.
5. Hayek, *Rules and Order*, p. 17.
6. Clifford, W. K., *Lectures and Essays*, London 1879, as cited by Hayek, *ibid.*, p. 149.
7. Berlin I., *Vico and Herder: Two Studies in the History of Ideas*, London, 1976, p. 140, as cited in Kukathas, C., *Hayek and Modern Liberalism*, Clarendon Press, Oxford, 1990, p. 91.
8. *Ibid.*, p. 141, as cited in Kukathas, 1990, p. 91.
9. Hayek, *Rules and Order*, p. 5.
10. *Ibid.*
11. *Ibid.*, p. 19.
12. *Ibid.*, p. 44.
13. *Ibid.*, p. 19.
14. For anthropological evidence of the rule guided nature of primitive societies devoid of purposive control or central direction see Hobel, E. A., *The Law of Primitive Man*, Harvard University Press, Cambridge, Massachusetts, Harvard University Press, 1954, and Benson, B. L., "Enforcement of Private Property Rights in Primitive Societies: Law without Government", *Journal of Libertarian Studies* 9 (winter): 1-26, 1989.
15. *Ibid.*, p. 15.
16. *Ibid.*, p. 148.
17. *Ibid.*, p. 16.
18. *Ibid.*, p. 17.
19. *Ibid.*
20. *Ibid.*, p. 12.
21. *Ibid.*, p. 14.
22. Hayek, F. A., *Individualism and Economic Order*, Routledge, London, 1948, p. 113.
23. Hayek, *Rules and Order*, p. 47.
24. *Ibid.*, p. 48.
25. *Ibid.*, p. 45.
26. Most notably in Hayek, F. A., *Law, Legislation, and Liberty: Volume 3, The Political Order of a Free People*, 1979.
27. Many functions which are traditionally conducted by central rather than local government may either be left to the market or to the autonomous governmental units. Effective competition between these units should allow those units with the best balance of public or private provision to prosper, their success may result in a replication of their practice. Neither policing nor monetary policy would be conducted by central government (except for the limited coercive power necessary to fulfil the function of the central government as outlined above). Hayek believes that monetary policy can be left to the market. See Hayek, F. A., *Choice in Currency*, Institute of Economic Affairs, London, 1976, although some regions may wish to experiment with government provision of this, or any other, service. The size and shape of the units could be determined by the voluntary combination of individuals and their property to receive the benefits of government, or the establishment of new communities for those who wanted to establish a new system. Those who did not establish such units would not receive the benefits, and thus would suffer resulting financial loss (e.g. a drop in property value due to lack of policing and street lighting etc.). Alternatively the units could be established politically, although this would be less consistent with Hayek's theory of spontaneous order.
28. 'Austrian' is the term given to describe the economic methodology of among others, Carl Menger, Ludwig Von Mises and Friedrich Hayek. The central feature of the Austrian tradition is a rejection of static equilibrium as espoused by the mainstream neo-classical school, and an emphasis on the role of entrepreneurialism in economic processes. For a good introduction to Austrian economics see Kirzner, I. M., *How Markets Work: Disequilibrium, Entrepreneurship and Discovery*, Institute of Economic Affairs, London, 1997.
29. The term "market wise intervention" is used by Shearmur to describe a contemporary challenge to a free market order which accepts the market but which wishes to intervene in its workings "in pursuit of their favoured values". Shearmur, J., *Hayek and After: Hayekian Liberalism as a Research Programme*, Routledge, London, 1996, p. 65.
30. An example of "market wise intervention" would include Hutton, W., *The State We're In*, Vintage, London, 1996. Hutton explicitly bases his central attack upon the 'New Right' on the practical and theoretical failures of neo-classical economics; at no point does Hutton discuss or even acknowledge the epistemological concerns raised by Hayek, or the Austrian theory of economics, despite their central role in the rejuvenation of the free market thought.
31. What is meant by "rational" is not clear. If rational is to mean simply that an assessment of benefits and costs is undertaken, then clearly a socialist system will be rational, as an analysis (however basic and devoid of relevant knowledge) of relative benefits is integral to any decision. If rationality requires an idealised model in which resources are best allocated towards satisfying consumer desires (or another selected end) then socialism is not capable of rational calculation. However if the idealised model is the requirement then Austrian economic analysis would show, due to its emphasis upon disequilibrium and imperfect knowledge, that a capitalist order is similarly incapable of rationality. The term rational, when applied to the process of calculation, is thus of little value unless used as a relative concept in which one system is said to use resources in a more (or less) rational manner than another system. We should therefore understand the claim of Mises to be that economic calculation will be less rational in a socialist society than in a market based society, in that it will be less successful in using the resources of society in order to satisfy the subjective preferences of individuals.
32. Being prepared to pay is not the same as actually paying. The market may provide a good at a price cheaper than what you are prepared to pay (e.g. water), but will not provide it at a cost higher than your subjective valuation. So the value accorded to a good is the price you will, if necessary, pay in order to receive the good, and this value tells market agents how much resources it is worth using in order to ensure the supply of the product.
33. Hayek, F. A., *Law, Legislation, and Liberty: Volume 2, The Mirage of Social Justice*, Routledge, London, 1976, p. 116.
34. Gamble's summary of the Marxist position, Gamble, A., *Hayek: The Iron Cage of Liberty*, Westview Press, Colorado, 1996, p. 63.
35. Hayek, *The Mirage of Social Justice*, p. 116.
36. Any suggestion of even distribution of resources which can then be used in a market context is internally contradictory and not credible economically. It is internally contradictory since a market process (to which incentives are fundamental) necessarily redistributes resources to those who operate on the best information, thus causing inequality of resources and destroying the even distribution. If an even distribution of resources is to be preserved then incentives, and thus the market, will cease to function. It is not credible economically because investment projects require different levels of investment and thus concentrations of wealth. While such investment could (theoretically) be provided by the combination of market agents into companies for this purpose, to do so is, in reality, not practicable. Such projects, in order to raise the necessary capital, require widespread agreement which would be difficult to organise. While any one individual could not obtain above average benefits for the success of the project it would be difficult to see who would be prepared to persuade the large number of individuals required for a large project to put their capital into it.
37. Kornai, J., *The Socialist System*, Clarendon Press, Oxford, 1992, pp. 476-7, as cited in Gamble, *Hayek: The Iron Cage of Liberty*, p. 58.
38. Gamble, *Hayek*, p. 72.
39. *Ibid.*
40. *Ibid.*
41. *Ibid.*
42. Brand recognition provides real benefits to consumers, guaranteeing a certain standard of service or quality of product across a large geographical area. An example of this is the world-wide availability of Coke-a-cola which permits travellers to order a drink in almost every country in the world with a high degree of certainty of the quality and taste of the product in question.
43. "[C]ompanies are experimenting with decentralised management, including the formation of 'quasi-firms' within firms. For example, the Taiwanese electronics firm Acer has divided itself into a network of different businesses, each with its own management, personnel and salary structure. The headquarters employs only 80 people and obtains its revenues from dividends from the separate businesses and from charging other parts of the business for its services. Individual divisions do not have to buy from

- others within the group and, when they do, they are expected to pay normal market prices." Cowen, T., and Parker, D., *Markets in the Firm: A Market Process Approach to Management*, Institute of Economic Affairs, London 1997, pp. 29-30.
44. For an exposition of changes in the nature of capitalism, from craft production to computer aided design, see Cowan and Parker, *Markets in the Firm*, pp. 19-33.
  45. To understand the nature of the market order, writes Hayek, we must free ourselves of "the misleading associations suggested by its usual description as an 'economy'. An economy, in the strict sense of the word in which a household, a farm, or an enterprise can be called economies, consists of a complex of activities by which a given set of means is allocated in accordance with a unitary plan among the competing ends according to their relative importance." In contrast to this conception of an economy, in which a single scale of end is common to the whole, "the cosmos of the market neither is nor could be governed by such a single scale of ends; it serves the multiplicity of separate and incommensurable ends of all its separate members." He concludes that the confusion generated by the ambiguity of the word economy is sufficiently serious to warrant the adoption of another term which describes what we mean the market order. Hayek suggests the use of 'catalaxy' which he derives from the Greek verb 'katallatein' which he says "meant, significantly, not only 'to exchange' but also 'to admit into the community' and 'to change from an enemy to a friend'." Hayek, *The Mirage of Social Justice*, pp. 107-8. The reference to changing an enemy into a friend refers to the exchange process inherent to the market which, while maybe not performing the feat of reconciling enemies, helps reconcile their conflicting ends by permitting mutually beneficial transactions.
  46. Hayek, *Rules and Order*, p. 57.
  47. *Ibid.*, p. 82.
  48. *Ibid.*
  49. Hayek defines rules as "a propensity or disposition to act or not to act in a certain manner, which will manifest itself in what we have called a practice or a custom." *Ibid.*, p. 75.
  50. *Ibid.*, p. 74.
  51. *Ibid.*, p. 81.
  52. Kern, F., *Kingship and Law in the Middle Ages*, translated by Chrimes, S. B., London, 1939, p. 151. As cited *ibid.*, p. 83.
  53. Hayek, *Rules and Order*, p. 96.
  54. *Ibid.*, p. 78.
  55. *Ibid.*, p. 113.
  56. *Ibid.*, p. 103.
  57. *Ibid.*, pp. 102-3.
  58. "There can be no question that the recognition of property rights preceded the rise of even the most primitive cultures." Hayek, *ibid.*, pp. 107-8. In discussing anthropological systems Benson notes that in American Indian societies "property was universally held in individual private ownership" and the "Title considerations ... included (1) separation of title to different types of product; (2) ownership rights within the territory of an alien group (e.g. Hupas owned property inside Yurok territory); and (3) the division of title between persons (e.g. a fishing place could be owned by several persons and its use divided so that one person could use it one day, another the next; and so on). Ownership was complete and transferable. Exchange was facilitated by a monetary system." Benson, B. L., "Enforcement of Private Property Rights in Primitive Societies: Law Without Government", *Journal of Libertarian Studies* 9 (winter), 1989, pp. 7-8. Ownership also carried responsibilities, for instance the owner of a fishing spot could rent out the spot to another, but would be responsible for the safety of the person who rented it, and would have to pay economic restitution if they slipped on a rock and injured themselves. Property rights could also differ slightly between societies (as is consistent with Hayek's theory of evolutionary change in the concept of property and contract etc.). "For instance [in Yurok law], a canoe owner was obliged to ferry a traveller across the river if it was requested. Refusal resulted in restitution to the traveller. In this regard, however, the traveller was liable for any damages suffered by the canoe owner as a consequence of his ferrying. For instance, if the canoe owner's house burned down while he was ferrying the traveller, the traveller was liable for full damages. Property rights could clearly be quite complex." Benson, B. L., "An Evolutionary Contractarian View of Primitive Law: The Institutions and Incentives Arising Under Customary Indian Law", *The Review of Austrian Economics*, Vol. 5, No. 1, 1991, p. 75.
  59. *Ibid.*, p. 107.
  60. *Ibid.*
  61. "Property, in the wide sense in which it is used to include not only material things, but (as John Locke defined it) the 'life, liberty, and estates' of every individual is the only solution men have yet discovered to the problem of reconciling freedom with the absence of conflict." Hayek, *Rules and Order*, p. 107.
  62. *Ibid.*, p. 109.
  63. Freund, P. A., "Social Justice and the Law", in Brandt, R. (ed.), *Social Justice*, New Jersey, Englewood Cliffs, 1962, p. 94, as cited by Hayek, *ibid.*, p. 124.
  64. Hayek, *Rules and Order*, p. 88.
  65. *Ibid.*
  66. *Ibid.*
  67. *Ibid.*
  68. "When a real change in the law is required, the new law can properly fulfil the proper function of all law, namely that of guiding expectations, only if it becomes known before it is applied." Hayek, *Rules and Order*, p. 88.
  69. *Ibid.*, p. 89.
  70. Hayek asserts that in a competitive economy, in which the general principles of law are upheld; it is only a mixture of skill and luck on the part of the individual which determines their relative position in society. Outcomes, in such a society, are not deliberately distributed by central correction, and are therefore not the result of distributive decision. It is therefore something of a misnomer to refer to these outcomes as unjust because (so long as the rules of society are upheld) nobody has acted unjustly. Hayek compares the concept of justice in life to that of justice in a competitive game: we do not say a game was unjust because somebody lost, we only say it if the rules upon which the game was based were violated. See, Hayek, *The Mirage of Social Justice*, 1976.
  71. Public choice theory explains state action in terms of the rational self interest of politicians and bureaucrats; and shows these interests often to contrast with the interests of society. See Buchanan, J., *The Limits of Liberty*, University of Chicago Press, Chicago, 1975 and Mueller, D., *Public Choice II*, Cambridge University Press, New York, 1989.
  72. Hayek, *Rules and Order*, p. 118.
  73. For a consideration of polycentric law with an investigation of its occurrence in anthropological systems, see Bell, T., "Polycentric Law", *Humane Studies Review*, vol. 7, No. 1, Winter 1991/2, Benson, B. L., "Legal Evolution in Primitive Societies", *Journal of Institutional and Theoretical Economics* 144 (Dec.), pp. 772-88, 1988, Benson, B. L., "Enforcement of Private Property Rights in Primitive Societies: Law Without Government", *Journal of Libertarian Studies* 9 (winter), pp. 1-26, 1989, Benson, B. L., "The Spontaneous Evolution of Commercial Law", *Southern Economic Journal* 55 (Jan.), pp. 644-61, 1989, Benson, B. L., "Reciprocal Exchange as the Basis for Recognition of Law: Examples from American History", Florida State University Working Paper, or Benson, B. L., *The Enterprise of Law: Justice Without the State*, Pacific Research Institute for Public Policy, San Francisco, 1990.
  74. Berman, H. J., *Law and Revolution*, Harvard University Press, Cambridge, 1983, p. 10.
  75. Bell, T., *Polycentric Law*, p. 5.
  76. *Ibid.*
  77. *Ibid.*
  78. *Ibid.*, p. 6.
  79. Due to economies of scale almost all products and services can be provided most efficiently, at least in the immediate future, if they are provided for all. With regard to the benefits of standardisation Hayek admits that "It is ... at least conceivable that the British automobile industry might be able to supply a car cheaper and better ... if everyone were made to use the same kind of car." In arguing against such standardization he asserts that "Though in the short run the price we may have to pay for variety and freedom of choice may sometimes be high, in the long run even material progress will depend on this variety, because we can never predict from which of the many forms in which a good or service can be provided something better may develop." Hayek, *The Road to Serfdom*, pp. 37-8. Although when discussing the merits and defects of standardization Hayek is addressing a different issue than the collective provision we are considering, a similarity between these issues exists since both are concerned with the extent to which individual liberty should be restricted in order to deliver cheaper goods and services. By examining Hayek's position on standardization we can tell that it would be a misunderstanding of Hayek to conclude that he desired the collective provision of every

- service if an argument could be made that to do so would increase efficiency. His justification for the collective provision of goods should, if it is to be seen as consistent with his approach to standardization, be seen as justifying collective provision only where entrepreneurial activity does not offer the prospect of circumventing current technical difficulties with regard to the private provision of those goods which can be provided less cheaply by the unguided market process. Such an approach would leave the vast majority of goods to be provided by the market, but leave certain goods/services (e.g. public parks or flood protection to be provided by the common funding). Of course this does raise the question of how we can know, in advance, what entrepreneurial advances can be made. The very notion of entrepreneurial activity, and indeed Hayekian epistemology, presupposes that no such advance in knowledge can be obtained (since such knowledge would require that we already know what we are going to discover, and is thus contradictory to the notion of discovery). It would seem that the only way of making any categorisation of where entrepreneurial activity can offer advances which can circumvent current technological difficulties is to consider what it is reasonable to hope such activity may produce; it would seem from Hayek's approach to standardization that in cases of doubt he would, where the provision of the good could, albeit more extensively, be provided by the market, favour market provision. However in cases where it seemed that the market was unable to provide a good, or the cost of it doing so was prohibitive to any one individual, that he would favour collective provision.
80. Hayek, F. A., *Law, Legislation, and Liberty: Volume 3, The Political Order of a Free People*, 1979, p. 44.
  81. *Ibid.*, p. 41.
  82. *Ibid.*
  83. *Ibid.*
  84. "The morality of this kind of coercion to positive action is, perhaps, not as obvious as the morality of rules which merely prevent the individuals from infringing the protected domain of others. Particularly where the collective good in question is not wanted by all or at least by a considerable majority, this does raise serious problems. Yet it will clearly be in the interest of the different individuals to agree that the compulsory levying of means to be used for purposes for which they do not care so long as the others are similarly made to contribute to ends which they desire but the others do not." Hayek, *ibid.*, pp. 44-5.
  85. *Ibid.*, p. 45.
  86. *Ibid.*, pp. 45-6.
  87. *Ibid.*, p. 46.
  88. *Ibid.*, p. 47.
  89. An example of such anti-competitive legislation is the monopoly enjoyed by the Royal Mail with exclusive rights over the delivery of all mail for fees of less than £1.
  90. Positive externalities are benefits which others receive from an activity for which they cannot (cost efficiently) be excluded from receiving the benefits. Negative externalities are the harms inflicted in the same manner.
  91. Hayek, F. A., *The Constitution of Liberty*, Routledge, London, 1960, p. 264.
  92. *Ibid.*
  93. An example of this could, in certain societies without sophisticated invasion detection systems, include a subsidy paid to a farmer, or a small community, to inhabit a remote area of land where they could (or naturally would), in return for that wage provide a warning of military invasion where, if not populated at all, an invading army could land and organise itself without detection.
  94. Hayek, *The Political Order of a Free People*, p. 54.
  95. *Ibid.*, pp. 54-5.
  96. *Ibid.*, p. 55.
  97. *Ibid.*
  98. It would seem that Hayek bases the justification for these claims upon a perceived necessity for such payments in order to diminish discontent with increased social mobility, which achieves its goal by balancing some of the adverse affects which accompany development. Such payments are not rights and depend entirely upon the nature of the society in which they are based.
  99. Hayek, *Constitution of Liberty*, p. 285.
  100. *Ibid.*, p. 257.
  101. "[T]here is more criticism of existing practices in Hayek's remarks than there is an unequivocal statement of alternative proposals."
  - Butler, E., *Hayek: His Contribution to the Political and Economic Thought of Our Time*, Temple Smith, London, 1983, p. 162.
  102. "Once it becomes the recognized duty of the public to provide for the extreme needs of old age, unemployment, sickness etc. ... it seems an obvious corollary to compel them to insure against the common hazards of life ... by neglecting to make provision they would become a charge to the public." Hayek, *Constitution of Liberty*, p. 286.
  103. *Ibid.*, p. 298.
  104. *Ibid.*
  105. "It may seem harsh, but it is probably in the interest of all that under a free system those with full earning capacity should often be rapidly cured of a temporary and not dangerous disablement at the expense of some neglect of the aged and mortally ill." Hayek, *Constitution of Liberty*, p. 299.
  106. If one does not wish to wait for the duration of current NHS waiting lists one must pay the full price of an operation and one will not receive any refund on money paid in tax for healthcare which was supposed to insure against the need for such operations. In a private insurance market one could supplement one's health insurance without foregoing what had already been paid, this would be particularly advantageous to those who cannot afford to pay for healthcare twice (public and private) but who could afford, and would like, to pay a little more than they currently do.
  107. So all values can be seen to be objective (including life itself), but subjective values which cannot be met inside the market place could justify state provision.
  108. Third party car insurance could be made compulsory without contradicting the notion of subjective value, and without leading down 'the road to serfdom'. Insurance of this type which does not cover risks to oneself or one's property but only risk to others could be justified with respect to Mill's harm principle (which could be seen to underlie all spontaneously generate legal systems) and in anticipation that a market based system of private roads would expect the same insurance. If roads were provided by a competitive enterprise (which Hayek does not think possible except for long roads) then it is reasonable to expect that, in order to make its roads have a safety record which would attract custom, the operator of the roads would insist on certain standards of driving, road-worthy cars (e.g. good tyres and brakes etc.) and some level of insurance to cover others costs. It would be reasonable, where private provision is not made in any service, to allow the state to make regulations similar to that which one would anticipate would be made by the market.
  109. See Patricia Morgan, *Farewell to the Family? Public Policy and Family Breakdown in Britain and the USA*, Institute of Economic Affairs, London, 1995.
  110. "The 1911 National Insurance Act was originally seen by Lloyd George, who chartered it through Parliament, as a way of extending the benefits of friendly society membership, already freely chosen by the vast majority of workers, to all citizens, and particularly to those so poor they could not afford the modest weekly contributions. But on its way through the House of Commons the original Bill was radically transformed by powerful vested interests hostile to working-class mutual aid. The organised medical profession had long resented the dominance of the medical consumer, and particularly resented the working class control of the 'medical gentlemen'. The BMA were equally anxious to obtain more pay and above all, higher status for doctors. Working class fraternalism also had another arch-enemy; the commercial insurance companies. They had long disliked the competition of the non-profit friendly societies and saw the 1911 National Insurance Bill as a threat to their business ... The unhappy outcome of legislation initially intended to extend to all citizens the benefits of friendly society membership, already chosen by the vast majority, was a victory for the political muscle of the [for profit insurers] and the BMA. They achieved a very considerable transfer of wealth and power from the relatively poor working class to the professional class." Green, D., *Working Class Patients and the Medical Establishment*, Gower/Maurice Temple Smith, Aldershot, 1985, introduction.
  111. The postal monopoly of the Royal Mail, as mentioned above, is one such example of a monopoly resting upon legislation.
  112. Hayek, *Constitution of Liberty*, p. 269.
  113. Friedman notes that it is usually cheaper, at least in the short run, for an aspiring monopolist to buy out his rival's companies. This was the technique employed by Rockefeller. Of course to buy out a rival one must pay the rival enough to make the sale worth his while. "[T]he trouble [with this] is that people soon realize they

can build a new oil refinery, threaten to drive down prices, and sell out to Rockefeller at a whopping profit. David P. Reighard apparently made a sizable fortune by selling three consecutive refineries to Rockefeller." Of course in a market which was already at capacity this excess capacity did little to help Rockefeller's profit, and as Friedman further observes having "built his monopoly on efficient business organization ... [Rockefeller] failed to maintain his monopoly." Friedman, D., *The Machinery of Freedom, Guide to a Radical Capitalism*, Open Court, La Salle, Illinois, second edition, 1995, pp. 34-5.

114. *Ibid.*, pp. 35-6.

115. Hayek, *Constitution of Liberty*, p. 308.

116. *Ibid.*, p. 315.

117. *Ibid.*

118. *Ibid.*, p. 323.

119. *Ibid.*, p. 310.

120. *Ibid.*, p. 312.

121. *Ibid.*, p. 317.

122. *Ibid.*

123. Hayek, *The Political Order of a Free People*, pp. 51-2.

124. *Ibid.*, p. 52.

125. Such a tax has little political feasibility, since its transparency would uncover the true level of taxation and thus render it very unpopular with taxpayers. It is generally easier for the state to collect taxation through numerous indirect sources of revenue and to deduct income tax at source.

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