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HAYEK, SOCIAL SCIENCE, AND POLITICS:
REPLY TO HILL AND FRIEDMAN

ABSTRACT: Hayek's case for the limits of economic agents' knowledge does not, as Greg Hill seems to suggest, imply that government should be in the business of engaging in countercyclical fiscal policy or paternalistic corrections of people's pursuit of "imaginary goods." In the latter case, markets have corrective learning mechanisms for consumer mistakes. In the former, public-choice and public-ignorance problems plague government efforts to correct the business cycle. The problem of public ignorance is, in turn, Jeffrey Friedman's topic, but he is unfair in condemning Hayek's abandonment of this problem in order to develop his thesis that a "planning mentality" was the source of the leftist ideas with which Hayek disagreed. Hayek was confronted by widely popular planning schemes that were endorsed by a great many of his colleagues, who were not ignorant of economics.

In his review of my book, Hayek's Challenge: An Intellectual Biography of F. A. Hayek, Greg Hill (2005) raises a number of important criticisms of Hayek's views on matters that he regrets I did not take the opportunity to address. Had I done so, he contends, my book would have provided an opening for increased dialogue with those outside the Austrian camp. Because of its lack of critical engagement with Hayek's views,
Hill (2005, 69–70) concludes that Hayek’s Challenge will probably not “appeal to a significant body of readers beyond those already sympathetic to the Austrian school of economics or to Hayek’s distinctive brand of liberalism.” Hill views this as lamentable, because overall he thinks that I did a good job expositing Hayek’s work, and because he thinks that Hayek has important and widely unnoticed insights to offer.

Every author knows that reading a review of one’s own work is a thrilling, humbling, and nerve-wracking business. There is, of course, always the possibility of an unfair or wholly negative review. But probably even worse is the problem of a reviewer who may “misunderstand” the author’s intentions. I use scare quotes because, as Karl Popper (1972) has told us, once an artifact like a book has reached World 3, it becomes its own entity; and as Stanley Fish (1980) has told us, authorial intentions are meaningless in a postmodern world, anyway. All of this, though, is of little solace to an author, because to the extent that a reviewer misses the message of a book, it becomes harder for the author to respond to the reviewer’s criticisms.

My book Hayek’s Challenge had a fair number of reviews, and some of them clearly “got” the messages I was trying to convey.¹ But many reviewers missed those messages, and I will here confess that part of the blame for this lies with me. Thus Hill is certainly right that I did not provide in the book any systematic critical assessment of Hayek’s views. That was not what I was trying to do in the book. But neither do I view myself as an uncritical admirer of Hayek, as one might infer from the absence of critical assessment. So what was I up to? Given that the readership of Critical Review is particularly important to me, I wanted to take the review by Hill as an opportunity to offer a few words of explanation.

Right through the copy-editing phase, my manuscript carried the subtitle, F.A. Hayek and the Limits of Social Science. The focus of my book was, accordingly, the emergence of Hayek’s methodological views. Having studied Hayek’s ideas over the years as an historian of thought, I came to believe that, for a number of reasons, focusing on his methodology would be an effective way to recount the emergence and evolution of Hayek’s most important ideas.

Hayek was concerned with a variety of methodological issues over his career, and it is evident in his work right from the start. A focus on methodology is there in the opening chapter of Monetary Theory and the Trade Cycle, it informs his papers on intertemporal equilibrium and on
economics and knowledge, it permeates his Abuse of Reason project, it is part of the reason he wrote The Sensory Order, it helps to explain his later writings on constructive rationalism and the hubris of reason, and it underlies his work on the theory of complex phenomena. In sum, it is a thread that unifies his work, one that explains his emphases and also some of his apparent detours. At least one of my goals was to explicate the many twists and turns in Hayek’s research path so as to make sense of his intellectual journey, and I felt that his persistent engagement with issues of social-science methodology provided a key to this problem.

But there was another reason for focusing on methodology. If Hayek was as right about the limits of social science as I believe he was about the limits of socialism and planning, his message has consequences for the practice of economics. In the final section I argued that he was indeed right, and offered as evidence the nature of what passes for “progress” in economics over the course of the twentieth century. I argued that there was progress of sorts, but that it was of a very different variety than would have been the case had economics truly been a positivist science of the type that has for so long been its self-image. I drew as one of my conclusions that if one accepts Hayek’s arguments about the limits of the social sciences, then there has been a misallocation of resources within economics, a discipline that continues to act as if the positivist ideal can someday be achieved. Thus, I argued against the current trend of eliminating the study of the history of economic thought and economic methodology from the economics curriculum. Such fields have an important critical role to play: all of the protagonists in the book, from Carl Menger and Gustav Schmoller to Sidney Webb, from Wesley Clair Mitchell and Lionel Robbins to Hayek himself, used their particular reading of their discipline’s history to point the best way forward, and to criticize alternative paths.

So though my book was very much about Hayek, in its conclusions it also went well beyond him. And I suppose that if my book struck Hill as uncritical, part of the reason is that I was indeed playing the role of an advocate, in that I was advocating that we pay closer attention to Hayek’s methodology. All this would have been more evident had Hayek’s Challenge carried the subtitle F.A. Hayek and the Limits of Social Science when it was published, rather than An Intellectual Biography of F.A. Hayek. The new subtitle was strongly recommended to me by the marketing department of the University of Chicago Press, on the grounds that the original one would limit my audience. Put another way, the suggested change would enable me to get my ideas before a
larger audience; or, less nobly, it would simply allow us to sell more books. And the title change was not really so misleading; mine was an intellectual biography in the sense that I paid very little attention to Hayek's personal life, and then mostly in footnotes. So I made the switch. But when I started reading reviews, I realized that it may have been a mistake. Many reviewers wanted to know why, in a putative intellectual biography, there was not a more balanced treatment of Hayek's views: why were his capital theory and The Road to Serfdom ignored, why was his monetary theory dealt with only to the extent that it was relevant to his methodology, and why did I spend about a quarter of the text on the methodological debates between the early Austrians and their positivist, socialist, and German Historical School opponents? Though it is from a slightly different angle, Hill's own question of why, in an intellectual biography, I did not offer more critical engagement with Hayek's intellectual legacy is of a piece with these other criticisms.

Hill offers the outlines of such a critique in his review. Some of his questions have to do with areas I neglected in the book; others play off some things that I did write about, though often from a perspective very different from the one I took. Given that Hill's overriding theme is that I did not open a dialogue with those outside the Austrian camp, I am happy to try, at least in part, to remedy the situation by responding here, however briefly, to some of the points he makes. As I do so, I also hope that it will become evident which parts of Hayek's ouvre I find most convincing, and which I find less so.

*Imagine This*

Hill opens with a fascinating set of questions provoked by Carl Menger's treatment of "imaginary goods." My point in highlighting Menger's discussion was to clarify the evolution of the Austrian treatment of subjectivism: though Menger was a subjectivist of sorts, Ludwig von Mises took Austrian subjectivism much farther, in the process criticizing Menger's approach. I argued that, contra the claims of Mises, there was nothing inconsistent in Menger's views—and frankly, I have in the past told people who are interested in subjectivism but who do not buy into the "Austrian" worldview that a closer look at Menger's work might pay dividends.

Hill thinks that my praise of Menger might rest on "the unsupported assertion that markets reduce the number and importance of imaginary
goods' over time” (71). This may have been something that Menger believed, but it was not why I defended him. In any event, my own view is that the market process both creates and destroys imaginary goods all the time—sellers of snake oil are constantly with us, and some people are taken in, and then they and others who observe them can learn from their mistakes. Markets provide incentives both to generate such goods, and to identify them as such.

That said, I think that the example Hill uses in his general discussion of subjective well-being (that real incomes have risen fivefold in Japan from 1958 to 1986, while surveys of Japanese subjective well-being have shown little change) does not really establish much. If one wants to know the effects on well-being of rising real incomes, a better test would be to reduce real incomes to one fifth of 1986 levels, and then see what people have to say about their subjective well-being. Common sense, as well as studies of loss aversion by behavioral economists, suggest that the pain would be great indeed.

Should Hayek Have Been a Keynesian?

Hill discusses the relationship between the views of Hayek and Keynes in three different sections. That I did not pay much attention to this relationship clearly caused Hill considerable disappointment. I should perhaps note that, as the editor of the volume titled Contra Keynes and Cambridge in The Collected Works of F. A. Hayek, I did, there, express an opinion on their debates. For what it is worth, I answered John Hicks's (1967, 203) question of “Which was right, Hayek or Keynes” with “Neither.” I used the (Hayekian) argument that if the business cycle is a complex phenomenon, then neither of the specific models of the cycle that our two protagonists developed was adequate. More generally, I must confess that I am much less impressed with the specifics of Hayek's 1930s monetary and capital theory than I am with the more general Austrian insights in these areas, as they have been articulated by such later writers as Roger Garrison (2001), Steven Horwitz (2000), and Lawrence White (1984).

Anyway, if I understand Hill correctly, his claim is that Hayek’s work on how money as a loose link destroys the equilibrium of the market system, and his work on how the dispersion of knowledge raises the whole question of how social coordination can occur at all, should lead us directly to Shackle's kaleidics, and from there to Keynesian kalei-
discs, which I presume (perhaps wrongly) implies for Hill an argument in favor of Keynesian policy interventions.

Speaking for myself, I think that Hayek's views imply that the stability of the market process in any given instance is always an empirical question—empirical in the sense that the speed of adjustment will differ across markets, and for the same market at different points in time, so that in each instance one will have to look at the specific market conditions that may hold.5 (I once said as much in the Austrian seminar at NYU, and Ludwig Lachmann nodded his assent vigorously, which is no surprise, for he, like many Austrians, had great respect for the work of George Shackle.) Very slow adjustments certainly can occur, and have occurred historically, and these often have social costs associated with them.6 The question naturally arises, what might be done in response?

It is here that Hayek's arguments about the limits of the social sciences, especially if they are linked up with Jeffrey Friedman's (2005) arguments about public (and elite) ignorance, as well as what Friedman (2005, xxxv) describes as "limited" public-choice arguments about government failure, suggest that direct government intervention may not be the best solution.

Let us take countercyclical fiscal policy as an example. We can leave aside the question of whether fiscal policy even works; a question that has, of course, been raised by Hayek among others—let's just assume that it can work. Even granting that assumption, there is still a timing issue, brought on by our ignorance of the state of the economy: because of the presence of a variety of lags between our recognition of a problem and the ultimate execution of policy to combat it, countercyclical fiscal policy could well end up exacerbating the cycle. Furthermore, even if we had perfect knowledge of when to run the policy, what chance is there that a democratic political process would yield the appropriate policy? Even under the best of circumstances, countercyclical policy goals may conflict with other policy goals of government. But we do not always have the best of circumstances: Can anyone look at the travesty that passes for legislative decision making in Washington, D.C. today (rife with the special-interest considerations in which public choice theory specializes) and assert with a straight face that we should trust such policy makers to make the right spending and tax decisions to counter the business cycle? More generally, the record of fiscal policy successes versus failures in most Western democracies suggests that
the knowledge and public-choice problems confronting policy makers are indeed formidable.

Another implication of the Austrian worldview, one that is again buttressed by public-ignorance considerations and by "limited" public-choice arguments, is that when an intervention is deemed necessary, there should be a presumption towards using market mechanisms whenever possible in executing it. The arguments supporting this presumption are varied. We often lack enough centrally collected information to intervene successfully, whereas properly functioning markets are good at utilizing dispersed knowledge. Many straightforward and popular interventions (e.g., price-fixing schemes like rent controls or agricultural price supports) have predictable negative, albeit unintended, consequences. Even when such interventions demonstrably do not accomplish their goals, once instituted they are difficult to get rid of because they are captured by and serve powerful special interests (though typically arguments for them are couched in terms of overcoming some economic or social injustice). And there are all sorts of costs associated with government intervention above and beyond the direct costs: government-run programs have few incentives to correct errors or to produce public goods efficiently, they lead to additional interventions when the initial ones fail to reach their goals, they generate costly rent-seeking behavior, they undermine individual initiative and responsibility-taking, they make it harder for private individuals to plan, and so on.

More generally, I agree with Hayek when he insists that a market system, one in which market prices are free to adjust, when embedded in a set of other social institutions—namely a democratic polity with well-defined, protected, and exchangeable property rights and a government operating under the rule of law, with strong constitutional protections of a sphere of individual activity, vague-sounding as that all may be—offers the best hope that dispersed knowledge can be coordinated and utilized by society, all while protecting individual liberty and encouraging individual responsibility for one's actions. I recognize, of course, that filling in the details of how to operationalize that vision is where many of the most bedeviling questions arise. This point is exemplified by Hill's recognition that although both Rawls and Hayek take a procedural approach to questions of justice, the conclusions that they reached differ substantially.

I recognize that in this short space I have not done justice to Hill's own lengthy and nuanced treatment, but I hope that I have at least
have been somewhat responsive to his concerns. In what remains I will amplify these remarks by providing some further commentary on Friedman's paper, "Popper, Weber, and Hayek: The Epistemology and Politics of Ignorance," which introduces the issue in which Hill's review appeared.

**Hayek's Alleged Blind Spots, and Their Reasons**

Friedman's piece is a wide-ranging and subtle essay that weaves together the ideas of Popper, Weber, and Hayek (as well as others, including Friedman's favorite whipping boys, public-choice theorists) in an analysis of the prospects for piecemeal social engineering in a world filled with ignorant actors. In discussing Hayek, Friedman praises his insight about how a competitive market process can help to overcome ignorance in economic dealings, but challenges Hayek's various political arguments against piecemeal social engineering, criticizing his claim in *The Constitution of Liberty* that the generality of laws is a guarantor of freedom; his claim (which Friedman reduces to a "verbal quibble") in *Law, Legislation and Liberty* that the term *social justice* is meaningless when applied to an impersonal market process; and his "semi-irrationalist defense" of the market (in *The Fatal Conceit*) as exemplifying a spontaneous order that has survived due to group selection (Friedman 2005, xxxiii–xxxiv).9

By far Friedman's harshest criticisms, though, are reserved for Hayek's warnings against what the latter variously labeled the planning or engineering mentality, scientism, and constructivist rationalism: the assumption by those on the left that "all social institutions are, and ought to be, the product of deliberate design" (Hayek 1973, 5), Friedman (2005, xI) acknowledges that Hayek's emphasis here was probably in response to "the planning mania that gripped some in the West between the world wars," but he argues that it ceased to have relevance after World War II. As such, "the persistence of this polemic even after the advent of the New Left must have seemed to any left-wing reader of Hayek like a well-honed obsession, as it completely ignored the postwar left's revulsion against authority, planning, and 'conscious control.'"

According to Friedman, those who are on the left do not oppose capitalism because it is unplanned, but because it is (they think) inegalitarian and inhumane, and they favor state action not because it is a source of order per se, being the product of deliberate design, but in-
stead because they think that it will provide a remedy for inequality and misery. Friedman concludes that Hayek should have dropped his whole "constructivist rationalism" line of argument, and instead should have explained the left's infatuation with statist remedies by means of a cognitivist argument: leftists are leftists because they are ignorant of sound economics, and one reason for this is that so many of the findings of economics are counterintuitive.

Though parts of his critique of Hayek are attractive, I would like to offer some qualifications to Friedman's narrative. He is certainly correct in noting that Hayek was responding to the planning mania that gripped England in the interwar years. Both Hayek's "Scientism" essay (1952b) and the historical analysis in "The Counter-Revolution of Science" (1952a) were parts of a larger, though ultimately unfinished, Abuse of Reason project that aimed at tracing the origins of the planning mentality to the writings of Saint-Simon and Comte—thereby showing how socialism, positivism, and the idea of a planned society all grew up together, and how this led to the objectivist, historicist, and collectivist approaches in the social sciences to which Hayek objected. The project was ultimately to have documented the spread of this agglomeration of ideas from France to Germany, England, and finally the United States, but Hayek decided instead to work on The Road to Serfdom, and then after the war turned his attention to other projects.

Unlike Friedman, I do not think that Hayek's focus on the planning mentality was misplaced. Friedman underestimates both the strength and the staying power of the mania. As I try to show in Hayek's Challenge as well as in the "Editor's Introduction" to The Road to Serfdom, calls for socialist planning were heard everywhere in 1930s England (Caldwell 2004, 232–37; Caldwell 2007, 7–9, 11–15). Economists were teaching courses in how to plan the economy at the L.S.E. Organizations like PEP (Political and Economic Planning) were producing reports on the planning of industry and agriculture, the managing of foreign trade, and the state provision of housing and social services. Politicians from across the political spectrum were heralding socialist planning as "the middle way." Natural scientists, Hayek's "men of science," were promoting the planning of society and the planning of science itself in books, in public appearances, at conferences, and on the BBC. In the United States, the Technocracy movement declared that advances in technology had brought vast increases in productive efficiency, eclipsing the necessity of a scarcity-based economic system. Through scientific management the technocratic state would ensure
that the benefits of technology are shared by all. Technocracy groups (called "sections") sprang up in many major cities. Everyone was sure that the world had changed, and that new tools were necessary. Respected writers like Peter Drucker (1939) announced "the end of economic man." John Maynard Keynes (1940) differentiated between the age of scarcity and the new age of plenty. It is difficult for us today to realize just how pervasive such views were.

Furthermore, enthusiasm for planning did not disappear after the war. Nationalization of approximately 20 percent of the British economy took place under the postwar Labour government in short order. To be sure, the urge to nationalize pretty quickly lost steam, as Western democracies came to prefer some form of redistributive welfare state to centralized control of production and distribution. But the ideas continued to have an impact. Planning approaches were exported to the newly emerging nations of Africa and other parts of the developing world, typically with disastrous long-run consequences. And like crabgrass, experiments in "new" types of planning have continually sprung up, from indicative planning in France in the 1960s, to industrial policy in the United States, to the establishment of a Network of European Technocrats in Europe in 2005—the last seeking to revitalize the Technocracy movement and establish it on a new continent. Nor should we forget that for nearly half a century, more than half of the world's population lived under centrally planned regimes.

Friedman's focus, however, is on the postwar Western left intelligentsia, which, as he notes, opposed authoritarian control and advocated personal freedom and self-determination, which in their eyes could come about only by ending social and economic injustice.

That many, if not most, on the left have always sincerely sought such noble ends is not in question. Hayek knew this. As Friedman (2005, xxxv) recognizes, Hayek never committed what Friedman (2005, xix) dubs "the cynic's heuristic": the attribution of bad motives to those with whom one disagrees. Right from the beginning Hayek insisted that he and his opponents agreed on ends, but disagreed on the means to achieve them. It is only after one gets beyond the vague generalities of "ending injustice," however, that one encounters the real issue: how that is to be done. So the right question here is: What workable proposals did the New Left put forth? How do they compare to Hayek's? On this score, Hayek can rightfully be faulted for seldom getting to the operational level, though he did at least provide some concreteness in last third of The Constitution of Liberty. In any event, one
might interpret such groups as the New Institutionalist Economics movement as trying to fill in the many blanks that Hayek left in his always very general framework.

Planning Mentality or Ignorance of Economics?

Finally, Friedman questions why Hayek took the approach of trying to explain how some exogenous variable (whether a planning mentality or something else) had pushed his opponents to accept what he felt were evidently erroneous beliefs, rather than having simply noted that sound economic reasoning is difficult to follow, and then having tried to promote it.

Friedman’s perhaps rhetorical question is, in my opinion, easy to answer. In his 1933 inaugural lecture, Hayek in fact took the tack that Friedman recommends, noting that economists repeatedly are pointing out that bad policies get instituted because the economic reasoning that would forestall them is difficult to follow. Friedman (2005, xxxviii–xxxix) approvingly quotes from the lecture, for it showed that, at least for a while, Hayek was (from Friedman’s perspective) on the right track. But Hayek soon thereafter turned to trying to explain why people found socialism so attractive. The reason for the switch is simple to explain: in the environment he found himself in, Hayek’s first argument could go nowhere. For not just the public, but most of his economist colleagues as well, had abandoned sound economic reasoning—as suggested by the litany of planning enthusiasms I’ve listed.

In criticizing Hayek, Friedman (2005, xlii) states:

The “planning-mentality” thesis rests on the very fallacy Hayek the economist so brilliantly dissected. It assumes something like perfect knowledge among those with whom Hayek disagrees: knowledge of economic theories with which Hayek agrees. Only given this assumption do we need to invoke a causal force such as “constructivist rationalism” to explain why leftists are on the left—as if there is something unnatural about being there.

Hayek’s economist opponents, however, did know about the theories with which Hayek agreed, and rejected them in favor of theories that he thought were false. The assumption that Friedman holds out as necessary to explain why Hayek might invoke constructivist rationalism to explain the beliefs of his antagonists was in fact met.
Having said this, I think that Friedman is right that, in the end, Hayek's cognitivist argument—that economics, due to its complexity, is counter-intuitive, and that that is why so many in the past have found, in the present do find, and in the future will find economics unconvincing—though depressing, is true. It is one reason why I called for a return to an emphasis on "basic economic reasoning" in my book. In the sort of world we live in, that is the strength of economics, and it is the place where the discipline can make a real contribution: in helping us to recognize our own cognitive limits and the limits of our conceptual and policy tools, and thereby helping us to avoid repeating the simple but attractive mistakes of the past.

NOTES

1. Two examples are the reviews by Francis Fukuyama (2004) and Steven Horwitz (2005). Horwitz's review was particularly welcome in that he drew attention to the "striking resemblance between Hayek's theory of the mind and the Austrian theory of capital" (2005, 82), something that I had missed, but that fits very well into the story I was trying to tell about the development of Hayek's ideas.

2. I intended my argument to be taken as a call for change rather than as either a sign of surrender or, even worse, as a post mortem.

3. The reason I spent so much time on background is that the whole approach of the Austrians is, to put it bluntly, incomprehensible to any economist trained exclusively in the standard neoclassical tradition. One of the implications of the disappearance of the history of thought from the economics curriculum is, of course, that this sort of problem will only increase in the future.


5. In some markets, underlying conditions change so frequently that the whole notion of adjustment to an equilibrium is problematic. Again, the extent to which this is true for any given market in any given period is an empirical question.

6. Of course, some of the most egregious examples of slow adjustments have been when price-fixing of various sorts occurs: one way to read the history of rent controls in New York City is that controls, and the continual addition of new laws to support them, have kept the rental housing market from adjusting properly for nearly 70 years.

7. See Klein and Clark 2006, 477–81, for a list of some concrete suggestions for reform, most of which I would endorse. I say "most" because personally I am a bit wobbly on antitrust.

8. Hill rightly wonders why Hayek sought to minimize the differences between his views and those of Rawls (in the preface to Hayek's The Mirage of Social Jus-
tice [1976, xiii]). Many, including myself, have wondered about this. At a conference, Chandran Kukathas reported that Hayek had once answered this question by saying that his assessment of Rawls in *Law, Legislation and Liberty* had been based on his reading of Rawls's earlier work, rather than on *A Theory of Justice*.

9. Friedman's treatment here is very brief, so my comments will be, too. While acknowledging the cogency of Ronald Hamowy's (1971) critique of Hayek's criterion of general rules, I have more sympathy than Friedman does for what might be called the "commonsensical" interpretation of Hayek's position: that emphasizing procedural rather than outcome-based approaches, or the rule of law over the rule of men, or the importance of the categorical imperative, though in no way guaranteeing good outcomes, at least points us in the right direction. I say commonsensical because these are just the sorts of considerations that ordinary people make reference to when they are trying to set up a fair competitive environment, as I tried to demonstrate with the example of how teachers set up classrooms in *Hayek's Challenge* (Caldwell 2004, 350–52). I feel that these arguments have much more purchase than Hayek's later quibble about "social" justice. As to Hayek's invocation of spontaneous orders, I think that his argument has not always been properly interpreted, and I certainly do not think that he committed the naturalistic fallacy of asserting that anything that survives a selection process is optimal. (For further elaboration, see Caldwell and Reiss 2006.)

10. Hayek recognized this in his preface to the 1956 American paperback edition of *The Road to Serfdom*, noting that "the hot socialism against which it was mainly directed ... is nearly dead in the Western world" (Hayek 2007, 44). He went on to say that "that hodgepodge of ill-assembled and often inconsistent ideals" known as the welfare state had its own dangers (ibid.).

11. Indeed, in his review of *The Road to Serfdom*, Joseph Schumpeter (1946, 269) called it "a polite book that hardly ever attributes to opponents anything beyond intellectual error. In fact, the author is polite to a fault; for not all relevant points can be made without more plain speaking about group interests than he is willing to resort to."

12. Hayek (1933, 18) spoke of "the recurring intellectual isolation of the economist."

REFERENCES


