PHILOSOPHY OF ECONOMICS & POLITICS

LECTURE 8: HAYEK

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Today’s agenda

• Today’s topic is Hayek, specifically his book *The Road to Serfdom*

• As usual, I will talk a little bit about his life

• And, in this case, about the enormous political influence he’s had

• Many of the ideas in *The Road to Serfdom* are direct responses to socialist tendencies he perceived at the time
Friedrich Hayek

- 1899-1992
- (Austrian) economist and philosopher (political theory, philosophy of science)
- As economist, his main contributions are to:
  - The theory of business cycles
  - Investment theory
  - The economic calculation problem/socialist calculation debate
  - Monetary theory (advocate of ‘free money’)
- As political philosopher, he is best known for his defence of classical liberalism
- Taught at the LSE, then Chicago (but not in economics!), then in Freiburg
Friedrich Hayek

- 1974 Nobel Prize for his “pioneering work in the theory of money and economic fluctuations and ... penetrating analysis of the interdependence of economic, social and institutional phenomena.”

- Tons of further honours:
  - Appointed a member of the Order of the Companions of Honour by Queen Elizabeth II in 1984
  - U.S. Presidential Medal of Freedom by Bush senior in 1991
  - “The Use of Knowledge in Society” was selected as one of the top 20 articles published in *American Economic Review* during its first 100 years in 2011

- Enormous political clout: e.g., directly influenced ‘Reaganomics’, Thatcher, Honorary Chairman of the Centro de Estudios Públicos in Pinochet’s Chile
The title was inspired by – who else? – Alexis de Tocqueville.

Recall that among the dangers of democracy he observed in *Democracy in America*, were the negative effects centralisation could have for individual liberty.

In later work Tocqueville explicitly commented on socialism.

*The Road to Serfdom* can be regarded as a detailed study of the mechanisms through which the desire for equality would lead to the abolishment of individual liberty.

The book has received praise across the political spectrum.
Hayek: Main Ideas (on C&D)

- I will focus here on three issues that directly connect with our discussion of Schumpeter:
  - **The economic viability of socialism**: he (explicitly) disagreed with Schumpeter and provided highly original arguments to the effect that socialism was not economically viable.
  - **The compatibility of socialism and democracy**:
    - He argued that totalitarian ideas are not opposed to socialism, but in fact a necessary consequence.
    - ‘Democratic socialism’, even though he granted that most Western socialists genuinely believed in the idea, to him was an oxymoron.
    - This is because any form of economic planning (whether aimed at equality or what have you) will eventually undermine democracy because individuals do not agree on values.
    - Moreover, any large-scale planning will involve infringements of personal or political liberties.
  - **The survival of capitalism**: he was more optimistic and indeed fought for it.
The viability of socialism

- Hayek’s views are impossible to understand without discussing the so-called ‘socialist calculation’ (aka ‘economic planning’) debate

- Started by Ludwig von Mises in a 1920 article which argued that because socialism means state ownership of the means of production there can be no markets, with no markets there can be no (non-arbitrary) prices, and without (non-arbitrary) prices, there could be no rational allocation of the factors of production

- Prominent socialist economists attempted to refute this logic and demonstrate the feasibility and indeed superiority of socialism over capitalism

- ‘Lange model’: uses the mathematical resources of neoclassical economics to portray an economy in which a central planning board allocates investment and capital goods and labor and consumer goods are allocated by markets; the planning board simulates a market in capital goods by a trial-and-error process
Hayek on socialist calculation

- ‘The Use of Knowledge in Society’ (1945)
- The economic problem is **not** one of finding a vector of relative prices **given knowledge of everyone’s preferences and available means**
- Rather: how do we best make use of information given not to any single mind but dispersed across all members of society
- Because for most economic decisions the **local knowledge** of the particular circumstances is crucial, a **central planning system will never outperform a system which builds on decentralised markets** in which individuals communicate information through the price system
- Models such as Lerner’s fail to get to the core of the issue: **they assume information to be ‘given’ which simply wouldn’t be available outside of a market system**
Hayek’s argument against the compatibility of socialism and democracy is premised on the assumption that socialism necessarily involves what he called ‘economic planning’.

Planning is ‘a central direction of all economic activity’ according to a single plan, laying down how the resources of society should be “consciously directed” to serve particular ends in a definite way.

The contrast is not generally with ‘laissez-faire’ but the creation of the conditions under which competition can thrive.

Thus, Hayek did not advocate abolishment of government altogether (as do some libertarians); rather, the government has important roles in enabling competition:

- Institutions like money, markets, and channels of information—some of which can never be adequately provided by private enterprise
- Interventions for social problems that cannot be solved by markets (externalities, monopolies)
- Some kind of social insurance
Socialism Involves ‘Economic Planning’

- Why does socialism involve planning?

- There are two meanings to the term ‘socialism’ (cf. von Mises 1920):
  - **Social justice**, greater equality, security – certain aims of society
  - **Abolition of private enterprise**, individual property, and collective planning – the means by which the aims are to be achieved

- **The ends cannot really be divorced from the means**: we need planning to distribute incomes equally, whether by regulation or by nationalisation

- To exercise economic planning in democratic fashion would require what Hayek called a ‘**complete ethical code**’
‘Complete Ethical Code’

- By that he meant, essentially, a complete agreed-upon preference ranking over every economic contingency in society.

- Obviously, we don’t have any such thing; we make economic decisions locally, on our knowledge of our specific circumstances.

- Majority vote works for decisions for which there are just a small number of alternatives; here the number of alternatives is vast.

- As for every decision there are losers, it is impossible to find agreement on most issues.

- (Politics should be limited to the sphere of decisions about which there is unanimous or near unanimous agreement.)
Planning Undermines Democracy

- Since there won’t be agreement on most issues, individuals will defer decisions to some political elite that takes over for them.

- But disagreements among experts/politicians/representatives will continue until one party takes over and imposes their view on everyone else.

- Even if the social goal is initially a limited one (e.g., equality of incomes), coercion will reach more and more spheres:
  - Why should I work in a dangerous occupation if I receive the same salary as everyone else?
  - Why should I work at all or if I do, put in any effort?
  - Individuals cannot signal that a specific good is highly desired, so the government will have to make decisions about which goods to produce and at what price to sell them – eventually telling people what to consume...
Planning Undermines Political and Personal Freedoms

- And **the problem does not stop at economic decisions** (this is what some socialists made us believe: economic dictatorship which leads to greater freedom elsewhere)

- This is because **economic ends cannot be separated from other ends**: money and wealth are ‘all-purpose means’ that enable us to do things we want to do and be the persons we want to be

- When there is competition and a supplier or employer rejects me, I can turn elsewhere; this is not possible when the state is an all encompassing monopolist

- This means that **freedom of religion, freedom of press and speech, and all sorts of personal freedoms will have to go**

- All this is made worse by the fact that in today’s world, because of the high degree of division of labour, few goods are home made
Finally, Hayek on the Future of Capitalism

- Hayek thus believed that only capitalism could assure the continued existence of democracy and freedom

- Unlike Schumpeter, who idly stood by its demise, Hayek fought socialist and other anti-capitalist tendencies in society

- For example, in 1947 he founded the Mont Pelerin Society, a scholarly community arguing against collectivism

- This soon became part of a movement of think tanks aiming to influence policy according to classical liberal ideas (e.g., Institute of Economic Affairs, Manhattan Institute for Policy Research, Atlas Economic Research Foundation...)

- This movement is the essence of what today is called ‘neoliberalism’

- However, what is called ‘neoliberalism’ is often at best a caricature of the classical liberal ideas Hayek sought to promote