

THE EFFICIENCY PROPERTIES OF INSTITUTIONAL EVOLUTION:
WITH PARTICULAR REFERENCE TO THE
SOCIAL-PHILOSOPHICAL WORKS OF F. A. HAYEK

by

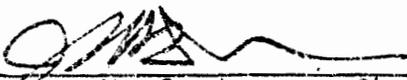
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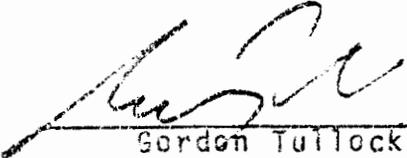
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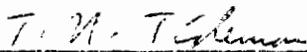
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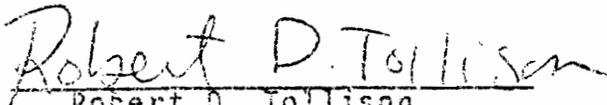
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TO MY MOTHER
AND FATHER

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INTRODUCTION

"Institutions evolve, but those that survive and prosper need not be those which are "best," as evaluated by the men who live under them. Institutional evolution may place men increasingly in situations described by the dilemma made familiar in modern game theory."¹ From this perspective, institutional evolution is thought to be less than completely desirable. The institutions, the orders, in general the outcomes of the evolutionary process, are oftentimes ranked low on the preference scales of those individuals that are affected by them.

The above view of the evolutionary process is not generally accepted, however. A close reading of the social-philosophical works of Professor F. A. Hayek would seem to lead to the opposite view. Hayek may be seen to be saying that the evolutionary process generates both efficient and desirable outcomes.

Given these two different views, it would seem that a closer look at the evolutionary process needs to be taken. Such an examination is the overall objective set for this dissertation. The important question that needs to be kept in mind along the way is: to what extent, and under what conditions, does evolution bring forth efficient and desirable outcomes. This is the specific question to be

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James M. Buchanan, The Limits of Liberty: Between Anarchy and Leviathan (Chicago, The University of Chicago Press, 1975):x

examined and with particular reference to the writings of Hayek.

The answer to the question above will be of direct, indeed profound, relevance to matters of policy and to attitudes toward policy. If it is true that the evolutionary process, as applied to social institutions, generates efficient and desirable outcomes, then policy prescriptions will certainly take on a passive nature. A "hands-off" attitude will prevail since this would be necessary in order for the "best" results to emerge and to exist. There would be no need to seek change in the existing order, since that which exists is already desirable and efficient, and, by inference, cannot be improved upon. Attempted improvements are not only superfluous, but harmful.

On the other hand, if the evolutionary process does not necessarily generate efficient and desirable outcomes, then policy prescriptions may take on an active nature, since in this case, the possibility of improving upon emergent outcomes exists. In that the proper policy position is important to the welfare of the individual and the collective, it is necessary to understand more fully the workings of the evolutionary process as applied to institutions. Only through understanding is it possible to eliminate those undesirable consequences that oftentimes arise when one makes and acts on mistaken assumptions.

CHAPTER I
TERMINOLOGICAL ISSUES

Certain terminological issues need to be addressed before a discussion of institutional evolution may commence. This essay will employ the same terms and phrases that Professor Hayek does in his work in socio-economic-political philosophy. Throughout these works, Hayek uses the words "order" and "institution" interchangeably and that same procedure will be followed here. While "order" has been preferred by Hayek in his later writings and because of this fact may appear to be the better word to employ, "institution" is still widely used by many persons. It would seem, then, that neither word has a clear advantage over the other. In any case, "order, or "institution" refers to 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."¹ Other words that refer to this phenomenon are "structure," "pattern," and "system."

¹ F. A. Hayek, Law, Legislation and Liberty, volume I: Rules and Order (Chicago, The University of Chicago Press, 1973):36

During the course of the dissertation, reference will be made to emergent and constructed "outcomes" as well as to emergent and constructed "institutions" and "orders." Outcomes, as well as institutions and orders, are subsumed under the category of "unintended consequences of human action," the phrase Hayek employs to describe most adequately the idea that is of concern to him. It is this idea that is of interest here, not whether it manifests itself specifically in terms of an institution, an order, or an outcome.

Hayek speaks of institutions-orders-outcomes within a Rationalist-Antirationalist framework, or classificatory system. Within this system, institutions-orders-outcomes either emerged or were constructed; they either evolved or were made.

When outcomes are spoken of as having emerged or evolved, this refers to their having been spontaneously generated by the actions of many individuals where it was the case that no individual had an idea of what his actions combined with others would produce. As Hayek has noted, "in a very definite sense, purposive institutions might grow up which owed little to design, which were not invented but arose from the separate actions of many men who did not know what they were doing."² They are, in Hayek's terminology,

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F. A. Hayek, The Constitution of Liberty (Chicago, Henry Regnery Co., 1960):58-59

"unintended consequences of human action."

Perhaps the ideal-type of emergent order for Hayek is the market, or as he refers to it, catallaxy. The market order is both efficient and desirable in that it is the visible manifestation of exchange -- a utility-gaining process. Individuals, seeking to maximize utility, will seek to make market transactions, the nature of any voluntary market transaction being that an increase in utility is gained. The gaining of utility through exchange, however, cannot be seen to be an "unintended consequence of human action," for exchange would not have been entered into in the first place had not the intention of gaining utility been there. There are, however, unintended consequences of the market order itself.

The market should not be narrowly defined as a place where individuals come to trade, but rather as the whole complex set of relationships between individuals and the unintended consequences of those individuals' actions. Hayek notes that an increase in knowledge is a characteristic of the market order and is an unintended consequence of individuals seeking to benefit themselves through exchange. He notes that "most of the knowledge on which we rely in the pursuit of our ends is the unintended by-product of others exploring the world in different directions from those we pursue ourselves because they are impelled by different aims; it would never have become available to

us if only those ends were pursued which we regarded as desirable."³ The market, which is means-connected as opposed to ends-connected, makes it such that individuals in seeking to reach their own ends provide others with information that will aid them in reaching their ends.

Another unintended consequence of exchange is that wealth is created. Hayek notes that the market is a "wealth-creating" game. "It is thus a wealth-producing game because it supplies to each player information which enables him to provide for needs of which without it he would have no cognizance, thus bringing about the satisfaction of a greater range of needs than would otherwise be possible."⁴ It should be noted that it is the increased knowledge, which itself is an unintended consequence of exchange, that generates the wealth-creating aspects of the market.

The market can also be seen to create wealth in that individual producer-sellers of goods will be cost-efficient. In that they do this, and they have every incentive to in a competitive market order, the total product in a catallaxy will be as great as possible.

A further unintended consequence of exchange, visibly manifested in the market order, is that the chances of

³ F. A. Hayek, Law, Legislation and Liberty, volume II: The Mirage of Social Justice (Chicago, The university of Chicago Press, 1976):111

⁴ Ibid:115

anyone picked at random for increasing his ability to meet his ends are better in a catallaxy than in any other order. For Hayek this is a characteristic of all spontaneous orders, not just a catallaxy. The freedom and the competition that are characteristic of all spontaneous orders makes this so.

Another commonly cited example of an emergent institution-order-outcome is money. In the process of an individual seeking to obtain his preferred bundle of goods he learns to exchange less marketable goods for those that are more marketable. Such exchange allows the individual to obtain more readily and less costly his preferred bundle of goods. Through this process, money emerges. As Menger noted: "As economic culture advances, a definite item or a number of items leaves the sphere of the remaining goods and becomes money, without legislative acts."⁵

Money can be seen to be a substantial improvement over barter in that it is both a resource saving device and a means for increasing market activity. By being the one good for which all other goods exchange, money makes superfluous the double coincidence of wants characteristic of barter exchange. Money makes it possible to release labor and capital from the process of distribution to that of production in that it economizes on the use of these

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Karl Menger, Problems of Economics and Sociology (Urbana, Illinois, University of Illinois Press, 1963):153

resources in the search-bargain process of exchange. By reducing the cost of exchange it leads to an increase in the number of exchanges that will be made and thus to an increase in utility for the individuals making the exchanges. Similarly, by being an asset which everyone is willing to accept as a means of payment, money enhances the opportunity for successful borrowing which, in turn, enhances market activity.

To say that an institution emerged does not mean to imply that no individual could have had the idea of the institution before its appearance. The fact that an individual or individuals possessed some mental construction or imagination of the institution before it appeared does not prevent the labeling of an institution as emergent; so long as the individual or individuals with the mental construction of the institution did not affect the eventual composition of the institution by a direct act on their part, the institution can be said to have emerged. For example, even a person living in a pure barter economy might have imagined how nice things would be if a money existed, but acting alone, he could do very little toward introducing the institution.

Constructed institutions, for Hayek, are those that are made or designed to meet a specific, and known objective. A constructed institution is designed with a particular end in mind. Here an important distinction needs to be made. There is a difference between construction on

an individual basis and construction on an aggregate basis. There is a difference, for example, between an individual planning a day's activities for himself and his planning a society. Construction on an aggregate scale implies that persons other than the constructor are subject to the construction. Construction on an individual scale subjects only the constructor to the construction.

At one level, the differences between emergent and constructed institutions-orders-outcomes are distinct. Constructed institutions-orders-outcomes are "designed," "made," or "blueprinted" while emergent institutions-orders-outcomes are not. Construction seeks a specific end and emergence does not. Here the differences between the two types of institutions-orders-outcomes are clearly and easily seen. At another level, however, the differences are not easily perceived.

In a sense, all institutions-orders-outcomes might be said to have emerged. This is the case when evolution is defined broadly. All that exists is said to have emerged, existence confirms evolution. Here evolution is an end, rather than a process that gives way to certain types of outcomes.

When defined broadly, evolution loses its true meaning. If everything that exists can be said to have emerged, then there is no way to differentiate between that which exists and was intended and that which exists and was unintended.

With such a definition, questions as to the rationale for the existence of something would not be forthcoming. At this level it would make sense to speak of the "evolution of constructed institutions." For example, a designed institution such as Social Security would be said to have emerged.

Similarly, all institutions-orders-outcomes might be said to have been constructed. It may be said that an institution is constructed through individual actions; after all, construction is subject to action, too. For example, those individuals that exchanged less marketable goods for those of greater marketability might be said to have "constructed" the institution of money through their actions. This is using the word "construction" in the broad sense. What separates construction here from the way it was employed earlier is the lack of a blueprint.

Throughout this essay, the terms "constructed" and "emergent" will be used in the narrow sense. This is consistent with Hayek's use of the terms. An institution-order-outcome emerged if it was spontaneously generated by the actions of individuals, where it was the case that no one individual had an idea of what his actions, combined with others, would produce. An institution is said to have emerged if it was an "unintended consequence of human action." Other words and phrases used to refer to this

phenomenon are: spontaneous order, self-generating order, cosmos and nomocracy. Nomos, or emergent rules, is observed in all the above.

An institution-order-outcome is labeled as "constructed" if it has been designed, on a larger than individual basis, with a specific end in mind. A blueprint has been drawn up and the details of it followed. Other words and phrases used to refer to this phenomenon are: planned order, made order, taxis, and teleocracy. Thesis, or constructed rules, is observed in all the above.

CHAPTER II
RATIONALISM AND THE EVOLUTIONARY APPROACH

In Chapter III the Hayek position on institutions-orders-outcomes will be presented. Here, however, some background on the philosophical foundations of the Hayek position will be noted. Two subjects of interest will be discussed: Rationalism and the evolutionary approach to institutions-orders-outcomes. More specifically, these will be looked at in order that greater insight may be gained when attention is turned towards the specifics and the implications of the Hayek position.

I

Hayek has stated that the ultimate purpose of science is to make the world understandable. In order to do this, it is important to proceed by way of the proper scientific method, and for Hayek, as well as for others (notably Popper, Polanyi and Oakeshott) this entails acknowledging the limits of human reason. "The Socratic maxim that the recognition of our ignorance is the beginning of wisdom has profound significance for our understanding of society."¹

It is with this in mind that Hayek so forcefully argues against the position that elevates human reason to a

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F. A. Hayek, The Constitution of Liberty (Chicago, Henry Regnery Co., 1960):22

supreme position. Rationalism is the name most often given to the position Hayek argues against. For Rationalists, human reason, most often defined as logical deduction from explicit premises, is the only criterion by which to understand and subsequently to judge institutions-orders-outcomes. Here, reason is supreme.

A confusion may enter in at this point. The Rationalist position may be interpreted to mean that if reason is the proper and only means by which to judge things, this does not preclude the fact that it can be "reasoned" that there are limitations to reason. This is Hayek's position, that is, that there are limitations to reason. For Hayek, reasoning that reason has limitations is employing the most effective use of reason there can be. As Hayek has noted: "Thus, if the desire to make reason as effective as possible is what is meant by Rationalism, I am myself a Rationalist. If however, the term means that conscious reason ought to determine every particular action, I am not a Rationalist, and such Rationalism seems to be very unreasonable."² Here, then, there are two different and contradictory definitions of Rationalism.

For purposes of argument and clarity, the two different and contradictory definitions of Rationalism need to be

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F. A. Hayek, Law, Legislation and Liberty, volume I: Rules and Order (Chicago, The University of Chicago Press, 1973):29

noted. If Rationalism is descriptive of both "the desire to make reason as effective as possible" and the belief that "conscious reason ought to determine every particular action," then the first type of Rationalism above shall be named "evolutionary rationalism" while the second shall be named "constructivistic rationalism." Popper has called them by slightly different names: true, Socratic, or critical rationalism, as opposed to false, Platoistic, uncritical rationalism. In this context, Antirationalism is the antithesis of Rationalism of the constructivist type only. One is an Antirationalist and an evolutionary Rationalist simultaneously since they refer to the same expressed thought with respect to reason and its uses.

The philosophical foundations of Rationalism and the predilections of Rationalists have been noted by a number of persons. It is important to note these here so that the Hayek position, which is, at essence, an antirationalist position, may be better understood. Furthermore, the study of the two positions is important because, as Popper has noted, the acceptance of one and the rejection of the other "will deeply affect our whole attitude towards other men and towards the problems of social life."³

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Karl Popper, The Open Society and Its Enemies, 5th Ed.
(Princeton, University of Princeton Press, 1950):232

Oakeshott has noted that "at bottom he (the Rationalist) stands for independence of mind on all occasions, for thought free from obligation to any authority save the authority of "reason." His circumstances in the modern world have made him contentious; he is the enemy of authority, of prejudices, of the merely traditional, customary or habitual."⁴

For a Rationalist, the mere existence of something does not, in itself, connote worth. To him that which exists and that which does not exist are of equal importance (or unimportance) outside of any other distinguishing features. "To the Rationalist, nothing is of value merely because it exists (and certainly not because it has existed for many generations), familiarity has not worth, and nothing is to be left standing for want of scrutiny."⁵

It is this attitude with respect to that which exists that makes change for the Rationalist an easy task. A Rationalist will tend to place reform in a secondary position to change. The psychology of the Rationalist is to start afresh, to make anew, not to patch up.

The Rationalist does not see that physical presence

⁴ Michael Oakeshott, Rationalism in Politics, and Other Essays (New York, Basic Books, 1962):2

⁵ Ibid:4

is not a sufficient condition for the existence of something. For a Rationalist, that which cannot be seen, or touched, or in any way physically sensed, does not exist. Oakeshott acknowledges this characteristic of Rationalists when he notes that they "can think of a law only as something written down."⁶ As will be seen later, this will be completely opposed to the way Hayek views the law.

It is in this sense, then, that Rationalism can be seen to be a rather limited and narrow way of viewing things. The Rationalist, by elevating reason to a supreme position, denies what Oakeshott calls practical knowledge, and what Hayek might refer to as non-articulated knowledge, is knowledge at all. For the Rationalist, "there is no knowledge which is not technical knowledge. Technical knowledge is knowledge that can be written down; it is factual, it can both be learned and taught in the simplest language. Practical knowledge, however, "can neither be taught nor learned, but only imparted and acquired."⁷ It is acquired only through practice. For example, it is "practical knowledge" that is acquired by the medical student when he is serving his internship and it is technical knowledge that he learned in medical

6 Ibid:5

7 Ibid:11

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school.

Not only do Rationalists deny that practical knowledge is knowledge, but they go one step further. They assume that their technical knowledge is complete and that it can be known to a single mind. Hayek has referred to this as the "synoptic delusion," that is, "the fiction that all the relevant facts are known to some one mind, and that it is possible to construct from this knowledge of the particulars a desirable social order."⁹

The synoptic delusion is simply an outgrowth of the basic beliefs of Rationalists: that problems can be solved wholly by appeal to reason and that all the knowledge that is needed to solve the problems is available.

Given the philosophical predilection of the Rationalists, it is quite easy to see how they came to interpret institutions-orders-outcomes in a constructivist light. A Rationalist will state that before something can exist and serve a purpose, it must be designed or modeled or constructed to do so. A Rationalist may routinely note that "good things don't just happen" (outside the

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See Michael Polyanyi on technical knowledge vs. practical knowledge. Personal Knowledge: Towards a Post-Critical Philosophy (Chicago, The University of Chicago Press, 1958)

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F. A. Hayek, Law Legislation and Liberty, volume I: Rules and Order (Chicago, The University of Chicago Press, 1973):14

conscious attempts of man).

This, of course, would be true if it were the case that one could only utilize knowledge if one is conscious of it. That this is true, though, is disputed by Hayek, Oakeshott, Popper, Polanyi et al. As they have pointed out, knowledge consists of more than that part which can be learned, taught and written, and because of these characteristics, be made conscious of; it also consists of that which cannot be learned, taught and written, but only acquired. And to acquire knowledge one does not have to be conscious of it. Furthermore, it does not follow that because one is not conscious of knowledge that it cannot be utilized. To deny such is tantamount to saying that people do not adopt practices and habits which serve them well, yet they are unable to understand how or why.

It is mainly the realization that man is able to make use of knowledge that he is not conscious of that leads Hayek, Oakeshott, Popper and Polanyi away from the constructivist approach of the Rationalists to the evolutionary approach of the Antirationalists.

II

The evolutionary approach notes that it is possible to observe institutions-orders-outcomes that are not the result of the conscious efforts of reason. That which exists may have grown, and this fact does not constitute

the denial of its serving a purpose. That which exists may serve a purpose even though no one intended that it would. In contrast to the Rationalist-Constructivist the Antirationalist-Evolutionist may note that "good things do oftentimes just happen" (outside the conscious attempts of man).

The evolutionary approach, which is largely an outgrowth of acknowledging the synoptic delusion, has a long and interesting history. Adam Smith, perhaps more so than any other person, took an evolutionary approach to things when he spoke of the "invisible hand." For Smith, man is "led by an invisible hand to promote an end which was no part of his intention."¹⁰ Smith and others have also noted that the end which was brought forth by the invisible hand was not unlikely to be one of great benefit to persons. "By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it."¹¹

Bernard Mandeville was perhaps the one responsible¹² for Smith's having become aware of the invisible hand.

¹⁰ Adam Smith, An Inquiry Into The Nature And Causes Of The Wealth of Nations, ed. Edwin Cannan (Chicago, The University of Chicago Press, 1976):421

¹¹ Ibid:421

¹² "If Dr. Hutchison could give us no lecture without attacking the Fable of the Bees, we may be sure that his student Adam Smith very soon turned to it." F. A. Hayek, New Studies in Philosophy, Politics, Economics and the History of Ideas (Chicago, The University of Chicago Press, 1978):102

Mandeville was one of the first to note clearly that the actions of individuals oftentimes produced an order that was not their intention, yet which, nonetheless, was not undesirable. Furthermore, for him, private vices would oftentimes produce public benefits.

This evolutionary approach was adopted by Hume. Hume was one of the first to note that morals, which Rationalists thought were either divinely ordained or the result of human reason, were instead the result of a natural evolutionary process. "The rules of morality, therefore are not the conclusions of our reason."¹³

Besides Smith, Mandeville and Hume, there were others who noted the phenomenon at hand: Adam Ferguson, Edmund Burke and Josiah Tucker. More recently such persons as Oakeshott, Alchian, Nozick and Hayek have all displayed an antirationalist attitude by describing in evolutionary terms much that exists.

Alchian has spoken of a process whereby that which exists need not have been planned or designed, but simply been of such a nature that it was "picked" by its environment to survive. Survival or existence may be seen to be as much dependent upon luck as it is upon anything else. "First, success (survival) accompanies relative

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David Hume, A Treatise On Human Nature (Oxford, Clarendon Press; 1955): 235

superiority; and, second, it does not require proper motivation but may rather be the result of fortuitous circumstances. Among all competitors, those whose particular conditions happen to be the most appropriate of those offered to the economic system for testing and adoption will be "selected" as survivors."¹⁴

Oakeshott's documented remarks on the limitations of Rationalism lead him to interpret things in an evolutionist light. When speaking of the history of modern European states, he notes that "each was the outcome of human choices, but none was the product of design."¹⁵ Elsewhere he notes that "they emerged, each as a piece of inhabited territory with a government; land, people and ruling authority were coeval."¹⁶

Nozick takes an evolutionary approach to things by giving an invisible hand explanation of the state. For him, "the de facto monopoly (the state) grows by an invisible hand process and by morally permissible means, without anyone's rights being violated and without any claims being made to a special right that others do not

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Armen A. Alchian, "Uncertainty, Evolution and Economic Theory," Journal of Political Economy, v.58, 1950:213-214

15

Michael Oakeshott, On Human Conduct (Oxford, Clarendon Press, 1975):185

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Ibid:185

possess."¹⁷

Through observation and the understanding of the limitations of reason, the authors above have come to note the existence and worth of the evolutionary approach as an explanation for much that exists. They have observed that the actions of individuals can many times give way to an outcome that none of the individuals intended.

As noted earlier, the authors above do not only come to the evolutionary approach through observation, they also come to it through an antirationalist position on reason and through the belief that knowledge is widely dispersed in society. These two positions would lead one, then, to conclude that it is possible for knowledge to exist and be utilized, yet one not be consciously aware of it.

The evolutionary approach that implicitly notes that something may have evolved over time and now serves a purpose would seem to verify this belief in knowledge. Something may exist and serve a purpose and thus possess much knowledge that persons are unaware of because of the simple fact that not all knowledge can be known in the Cartesian sense. This does not deny the fact that it can be utilized, however. The evolutionary approach to institutions-orders-outcomes seems to acknowledge this fact, while the constructivist approach denies it.

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Robert Nozick, Anarchy, State and Utopia (New York, Basic Books, 1974):115

It is probably already obvious from what has been said with respect to the evolutionary approach to institutions-orders-outcomes that the evolutionary process being discussed here is different from what is commonly thought to be meant by this phrase.

In this context, neither evolution nor the evolutionary process subsumes the existence of any "laws of evolution." Properly defined and understood, the evolutionary process is not an example of a process where something comes about (evolves) only through necessary stages. The Marxist conception that socialism is inevitable because it is the result of an evolutionary process where feudalism gives way to capitalism, and capitalism, in turn, gives way to socialism, is not what is meant by the evolutionary process in this essay. Marx's conception of evolution is mechanical, it is patterned. Here, Y will occur because it was preceded by X. There is a definite causal-effect relationship. In the Marxian conception of evolution there are definite "laws of evolution" that no one can undermine or prevent. These "laws of evolution" are also descriptive of Rostow's pronouncements on economic growth.¹⁸ Rostow's "five stages of economic growth" (where the traditional society gives way to the preconditions for take-off, and

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Rostow notes the similarity between his work and Marx's. See his The Stages of Economic Growth: A Non-Communist Manifesto (Cambridge, Cambridge University Press, 1960):148

the latter gives way to take-off, and so on) can be seen to display the same mechanical "evolutionary" relationship as does Marx's "stages of history."

The type of evolutionary process that is descriptive of both Marx and Rostow is not being discussed here. Evolution here refers to something quite different. It does not contain the stage-by-stage development that is part of the theories of Marx and Rostow. Nor does it consist of "laws of evolution." Here, nothing is predetermined. As Hayek has noted "the theory of evolution proper provides no more than an account of a process the outcome of which will depend on a very large number of particular facts, far too numerous for us to know in their entirety, and therefore does not lead to predictions about the future."¹⁹

Evolution, properly defined and understood, applies to the process describing how and why many things come about and exist for long periods of time, not to the description of predetermined outcomes and to the underlying fixed causal-effect relations that make up such outcomes.

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F. A. Hayek, Law, Legislation and Liberty, volume I: Rules and Order (Chicago, The University of Chicago Press, 1973):23-24.

CHAPTER III
THE HAYEK POSITION

In the Introduction Hayek was attributed with implying that emergent institutions are efficient and desirable. Emergent institutions he holds to be necessary for the existence and preservation of the "Great Society." In short, this seems to be the Hayek position with respect to institutional evolution.

The Hayek position needs to be developed more carefully and completely. Two things need to be illustrated: first, that the position attributed to Hayek is, in fact, **the** position that he holds. It is necessary to prove this since Hayek in his writings never openly and directly makes the statement that "emergent institutions are efficient." As the discussion below will indicate, however, a close reading of his writings would lead one legitimately to assign such a position to Hayek. Secondly, the development of the Hayek position needs to be traced.

While this chapter seeks to present the Hayek position, later chapters will attempt to test the validity of that position. With that in mind, issues concerning the full ramifications of the position, and the empirical support of it will be raised.

I

As noted briefly earlier, the Hayek position is

largely built upon the issue of knowledge. According to Hayek, a major difference between emergent and constructed institutions-orders-outcomes is the amount and type of knowledge that each allows individuals to utilize. In the desire of proving that Hayek holds the position attributed to him, and for reasons of clearly seeing how the Hayek position is developed, it will be necessary to quote Hayek at some length. On knowledge, the foundation stone of his position, Hayek makes three points. He first notes that knowledge is widely dispersed in society. He states that:

The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess.(1)

Hayek's second point concerning knowledge is that it is not always objective, quantifiable or capable of being articulated. On this he says:

The sort of knowledge which I have been concerned is knowledge of the kind which by its nature cannot enter into statistics and therefore cannot be conveyed to any central authority in statistical form. (2)

1 F. A. Hayek, "Use of Knowledge in Society" in Individualism and Economic Order (Chicago, Henry Regnery Co., 1948):77

2 Ibid:83

And on the same point he states that:

. . . not all the knowledge of the ever changing particular facts that man continually uses lends itself to organization or systematic exposition. (3)

Hayek's third point on knowledge concerns the fact that an individual can neither know, in the sense of being aware, nor understand all knowledge. On the first point:

But neither science nor any known technique enables us to overcome the fact that no mind, and therefore also no deliberately directed action, can take account of all the particular facts which are known to some men but not as a whole to any particular person. (4)

And on the second point:

Our intellect is not capable of grasping reality in all its complexity. (5)

The fact is however that the so-called anti-rationalists insist that to make reason as effective as possible requires an insight into the limitations of the powers of conscious reasons and into the assistance we obtain from processes of which we are not aware. (6)

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F. A. Hayek, The Constitution of Liberty (Chicago, Henry Regnery Co., 1948):25

4

F. A. Hayek, Law, Legislation and Liberty, volume I: Rules and Order (Chicago, The University of Chicago Press, 1973):16

5

Ibid:32

6

Ibid:29

From these three positive statements concerning knowledge, Hayek is led into a normative conclusion. He concludes that there is little, if any, room for trying to "change" or "improve" emergent institutions-orders-outcomes because in the process "we shall never be aware of all the costs of achieving particular results by such interference."⁷ Hayek proposes that emergent institutions-orders-outcomes not be tampered with, for in the process much knowledge -- knowledge that is largely invisible -- might be destroyed. Hayek dishearteningly notes the paradox that his invisible knowledge may only be "seen" once it has been lost. Many times it is only after the damage has been done that people are aware of this fact.

So far Hayek's position may be seen as one of saying, very simply and straight-forwardly, "leave well enough alone." This is a basic theme of much of Hayek's work in social philosophy. It is repeated over and over again.

II

This theme would seem to imply that Hayek puts great faith in social evolution. It seems unlikely that one would vehemently warn against tampering with emergent institutions if it was not thought that the emergent institutions were superior to what tampering would

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Ibid:57

produce. This faith in social evolution that Hayek exemplifies can be seen specifically in his description of "the law."

For Hayek, "the law," which is something very different than legislation, evolved. For him, it contains much of the knowledge that is missing in legislation. And in that it is simply the articulation of long standing rules, it is thought to be just; in that it has "passed the test of time," it is thought to be efficient.

As noted above the emergent order of "the law" is built upon long standing rules which evolved for a reason. Hayek states:

At this stage it is sufficient to see that rules did exist, served a function essential to the preservation of the group, and were effectively transmitted and enforced, although they had never been 'invented,' expressed in words, or possessed a 'purpose' known to anyone. (8)

The preservation of the group was assured when it followed long standing rules because these rules were "a device for coping with our constitutional ignorance"⁹ -- an ignorance, which if left unattended, would certainly have led to disharmony amongst the members of the group and to the eventual breakdown of the social order. General adherence

8 Ibid:75

9 F. A. Hayek, Law, Legislation and Liberty, volume II: The Mirage of Social Justice(Chicago, The University of Chicago Press, 1976):8

to long standing rules is a means by which this breakdown is prevented. Such rules not only assure the preservation of the group, but its progress as well. Over time, the "best" rules are accepted and followed because of the desirable results they produce.

These "best" rules can be seen as constituting what Hayek refers to as "the law."¹⁰ It is the "trial and error" process of evolution that leads Hayek to conclude that only those rules that facilitate the exploitation of the greatest amounts of knowledge (thus enabling persons the best chance to cope with the contingencies of an uncertain world) will survive. All other rules will be discarded as being unsuccessful in the pursuit of given objectives. Hayek's thinking with respect to institutional evolution seems to be accurately summarized in the statements above. Evolution will "choose" those emergent institutions-orders-outcomes which are the most successful in bringing the most relevant knowledge to bear on the problems at hand.

It is in this sense that Hayek notes the inferiority of legislation to law. Legislation, which may be described as "made" law, lacks the knowledge and the justice inherent in "the law." It is through Hayek's discussion of legislation, however, that one can see that he goes beyond simply

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It should be noted here that "the law" for Hayek manifests itself most nearly in English common law. See Appendix

noting the benefits of the law but attributes efficiency to it.

Economists usually speak of efficiency in a Pareto sense, that is, something is said to be efficient if there exists no possible rearrangements which could make one person better off without harming someone else. It is in this light that Hayek's warnings against the tampering with "the law" implicitly assumes it to be efficient. For Hayek a move away from the existing emergent order of "the law" may do great harm. This position must imply that it is efficient since movements away from it may well be harmful. Once again the Hayekian theme: "leave well enough alone."

To develop this point further, it is noted that movements away from "the law" mean either legislation or anarchy, both of which are undesirable to Hayek. Hayek's stand on legislation is well-documented. He notes that:

It gave into the hands of men an instrument of great power which they needed to achieve some good, but which they have not yet learned so to control that it may not produce great evil. (11)

Hayek's position on anarchy is similar to his position on legislation. This can be seen by noting that ~~in the~~:

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F. A. Hayek, Law, Legislation and Liberty, volume I: Rules and Order(Chicago, The University of Chicago Press, 1973):72.

state of anarchy there can be no freedom. It is "the law" that is necessary for the preservation of freedom. In that this is the case, anarchy is an undesirable situation for Hayek, for it means the end of that which he holds to be so precious. Thus, in that both anarchy and legislation bring with them the decline of freedom, they are both seen to be undesirable. Movements away from the "the law" in that they are most likely to do great harm, are seen to be inefficient.

A secondary issue in emergent law is that of the judge's role. It is important to note the judge's role here, for according to Hayek, he is the "institution of a spontaneous order" that "finds" "the law."

Judges, notably common law judges, are part of the process that "finds" "the law" and then acts to preserve it. The preservation of it is necessary for the continuance of the "Open" or "Great" Society. Judges, having recognized their obligation to make their decisions consistent with past decisions, "produce" an order (if only piecemeal) that is consistent with the workings of the "Great Society."

It is on the subject of the judge's role in "finding" "the law" that Hayek is subject to criticism. First of all, Hayek notes that the task of the judge is a difficult one:

Even where the judge has to find rules
which have never been stated and perhaps

never been acted upon before, his task will thus be wholly different from that of the leader of an organization who has to decide what action ought to be taken in order to achieve particular results. (12)

Hayek adds that the task is so difficult that judges must oftentimes "create the very language in which such rules could be expressed."¹³ Although the judge faces a difficult task, Hayek believes that he seldomly fails to reach a right decision. He states:

As has been truly said, the trained intuition of the judge continuously leads him to right results for which he is puzzled to give unimpeachable legal reasons. (14)

Infrequent wrong decisions are attributed to one of two causes: the judge "may not succeed in discovering what is required by the rationale of the existing order,"¹⁵ or "he may be misled by his preference of a particular outcome of the case in hand."¹⁶ These are the only reasons why

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F. A. Hayek, Law, Legislation and Liberty, volume I: Rules and Order (Chicago, The University of Chicago Press, 1973):97

13

Ibid:97

14

Ibid:117

15

Ibid:119

16

Ibid:119

a judge may be led to make a wrong decision.

It would seem that Hayek has missed an important point. An additional reason why judges may make wrong decisions is because they have little incentive not to. A true evolutionary conception of the law must take this point into consideration.¹⁷ A judge in making a judicial decision is, at essence, producing a public good. This being the case, he has little incentive to reach a right decision because the (small) benefits he receives from the provision of the public good would seem to be outweighed, in most cases, by the (large) costs he personally would have to incur in reaching the right decision. To ignore this cost-benefit calculation on the part of the judge is to omit an important part of the process the judge goes through in reaching a decision.

Some of the costs the judge may have to incur is the time and effort he must expend to "create the very language" to express heretofore unarticulated rules of conduct. Also, in that the judge has the "obligation" to make his decision consistent with those of the past, he must exert the costly behavior of reading, studying and reflecting upon past decisions.

If it is looked at in cost-benefit terms, it is easy to see that "finding" the law is more costly, relative

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The following analysis draws heavily on Gordon Tullock's "Public Decisions as Public Goods" Journal of Political Economy, 79, (July/August 1971):913-18

to benefits, than "making" the law. "Making" the law does not call for the skills, nor the time and effort, that is required in the task of "finding" the law. This might then be an acceptable explanation for why recent years have seen a move towards public law ("making" the law) and away from private law ("finding" the law). And it would seem that this outcome is an emergent one. No one planned it, it simply emerged out of the self-interested behavior of judges.

On this same subject, Bruce Ackerman's Private Property and the Constitution has something to say on the performance of judges as decision-makers. Ackerman, like Hayek, notes that the task of the judge is difficult. A close reading of his book would lead one to conclude that the task of the judge is to make clear that which is unclear. The judge is not normally concerned with matters of black or white, but rather with those in-between matters, those that are grey. His task is to somehow come to terms with these matters such that, in his mind at least, they become black or white. Certainly no one would doubt that this is a formidable task. Just how judges go about this task is the central theme of Ackerman's book.

In it Ackerman is "trying to illuminate the relationship between general philosophical perspectives and particular legal doctrines."¹⁸ Ackerman notes, by way of

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Bruce A. Ackerman, Private Property and the Constitution (New Haven and London, Yale University Press, 1977):84

observation and general theorizing, that judges take different approaches to answering legal questions. The "Scientific Policymaker" and the "Ordinary Observer" are two categories a judge may come under in rendering judicial decisions; and within these two categories there are sub-categories. Ackerman notes: "At least so far as I can see, our legal culture is sufficiently disorganized (or should I say schizoid ?) that many of its principal actors-- lawyers, judges, legislators -- move back and forth between the perspectives of the Ordinary Observer and Scientific Policymaker quite effortlessly with no sense of impropriety. Consistent with the genius of the common law, advocates are quite happy to indulge either form of argument when it suits their advantage. And judges (as well as legislators) are willing to rule neither kind of argument beyond the pale of legal thought, though they surely have no explicit criteria for determining the contexts in which one or the other legal form should be given preponderent, let alone exclusive weight."¹⁹

Judges in Ackerman's world, then, act somewhat differently than they do in Hayek's world. Armed with a certain criteria of justice, and with a particular world view, a judge may seek to right the wrongs that only he can see. Not only does this lead to inconsistent

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Ibid:168-69

decisions between judges but it is, in essence, judicial legislation, which is not far from, if not exactly equal to, one man rule.

Before going on, a point deserving of consideration needs to be noted. It is recalled that Hayek noted that a judge may make a wrong decision because he "may not succeed in discovering what is required by the rationale of the existing order." For Hayek to be consistent within his own framework, the order he is speaking about cannot have a "rationale" for it is a spontaneous order. More specifically, it is the spontaneous order of "the law" -- a cosmos. As Hayek notes: "Most important, however, is the relation of a spontaneous order to the conception of purpose. Since such an order has not been created by an outside agency, the order as such also can have no purpose, although its existence may ve very serviceable to the individuals which move within such order."²⁰

Within Hayek's framework an order can only have a purpose, a rationale, if it was constructed to have one; that is, necessary for it to have a rationale is that it must be a taxis. Given the distinction between a spontaneous order (cosmos) and a constructed order (taxis), and noting what each implies with respect to purpose or

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F. A. Hayek, Law, Legislation and Liberty, volume I: Rules and Order (Chicago, The University of Chicago Press, 1973):39

rationale, it would seem that Hayek by attributing a spontaneous order with a rationale has either overlooked his earlier admonition here, or redefined words without noting this fact. In either case, a confusion exists.

III

Special attention was directed above to the emergent order of "the law" since Hayek chose it to be of major concern to him. His remarks on "the law," however, hold true with respect to other emergent orders, as well as to emergent institutions and outcomes. There is little doubt that Hayek holds emergent institutions-orders-outcomes to be some of the greatest achievements of man. On this point he notes:

Many of the greatest things man has achieved are not the result of consciously directed thought, and still less the product of a deliberately coordinated effort of many individuals, but of a process in which the individual plays a part which he can never fully understand. (21)

Elsewhere he notes that emergent orders are indispensable to the achievements of man's aims.

Many of the institutions of society which are indispensable conditions for the successful pursuit of our conscious aims are in fact the result

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F. A. Hayek, The Counter-Revolution in Science: Studies on the Abuse of Reason (Glencoe, Ill., Free Press, 1952):84

of customs, habits or practices which have been neither invented nor are observed with any such purpose in mind. (22)

According to Hayek, emergent orders having "passed the test of time," possess some subtle features that benefit man. Having "passed the test of time" is an indication of this, since those orders that do not benefit man are quickly discarded in the overall emergent order of the "market."

The efficiency of emergent orders is largely dependent upon, however, the fact that they are necessary for the existence and preservation of the Great (Good or Open) Society. "The Good Society is one in which the chances of anyone selected at random are likely to be as great as possible."²³ It is the society "in which we would prefer to place our children if we knew that their position in it would be determined by lot."²⁴

For Hayek, a move towards the "Great Society" would seem to benefit all persons. Therefore in the language of welfare economics such a move would be Pareto-superior. The "Great Society" is then efficient for the group. One condition needs to be noted, however. The "Great Society"

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F. A. Hayek, Law, Legislation and Liberty, volume I: Rules and Order (Chicago, The University of Chicago Press, 1973):11

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F. A. Hayek, Law, Legislation and Liberty, volume II: The Mirage of Social Justice (Chicago, The University of Chicago Press, 1976):132

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Ibid:132

benefits all persons, and is therefore efficient in the sense that "for any person picked out at random, the prospects that the overall effect of all changes required by that order will be to increase his chances of attaining his ends!"²⁵ And it is the emergent orders that guarantee the benefits of the "Great Society" will be forthcoming. They are the orders that "produce" the efficiency of the "Great Society" and in the process cause efficiency to be ascribed to them.

Technically, a "Great Society" does not aim at particular results, but, rather, at "increasing the chances of those picked at random." As noted, emergent orders assure this. "A policy making use of the spontaneously ordering forces therefore cannot aim at a known maximum of particular results . . ."²⁶

Proceeding one step further, Hayek believes that individual freedom is maximized only in the "Great Society," which, it was shown above, relies for its existence and preservation on orders that are largely outside the grasp of human reason. "Freedom means that in some measure we entrust our fate to forces which we do not control."²⁷ This statement seems to put great faith in social evolution. The theme of "let well enough alone" is uttered one more time.

25
Ibid:114

26
Ibid:114

27
Ibid:30

CHAPTER IV
THE PRECONDITIONS OF THE "GREAT SOCIETY"

The Hayek position attributes efficiency to emergent institutions-orders outcomes. "Unintended consequences of human action," in that they allow individuals to utilize the most knowledge possible and are largely coercion-free, are the "best" results man can hope to attain.

Hayek, then, would appear to be an evolutionist; after all, he does speak of an "evolutionary process" through which institutions-orders-outcomes appear. A close reading of Hayek's work, however, would lead one to question to what degree, if any, Hayek is an evolutionist in the strict sense of this word. It would seem that Hayek's whole notion of emergence holds only if the environment is specified to be of a certain sort. In that this is true, Hayek cannot be an evolutionist in the full sense of this word. One cannot be an evolutionist and specify a required set of environmental constraints too.

I

Of the two ways of viewing evolution only one is meaningful. Both ways, however, refer to evolution as a process in which something develops from one stage into another, and so on. One way of viewing this process

is within a specified environment. The "evolution" of something occurs given certain specified conditions. Here the outcome of the "evolutionary process" is determined in the sense of being "bounded" within certain limits.

A second way to view the "evolutionary process" is as taking place within an unspecified environment. Here, where there are no specified conditions, the outcome is largely undetermined. This would seem to be the only meaningful way to view evolution. Evolution, if it is to mean anything at all, must take place within an unspecified environment; failing this, the phenomenon at hand would have to refer to something else. In fact what it does refer to is construction of a certain type.

This construction is a less visible type than was spoken of earlier, yet it is construction in that it specifies, notably it specifies the constraints in which "evolution" is to take place. It does not guarantee an "end" or "end-state," but, rather, bounds or limits the range of "ends" or "end-states" that may come about.

It is this less visible type of construction that Hayek employs. Hayek's specification of the environment in which the "evolutionary process" is to take place guarantees him efficient outcomes. That which might lead to a less than desirable or efficient outcome is filtered out by the generalized constraints that bound the process.

For Hayek, the specification of the environment which is conducive to the "evolution" of efficient orders takes the form of being one where general rules are equally applicable to all.

As in most cases, the burden of proof lies with the one who advances the claim. It now needs to be shown that Hayek does specify his environment in such a way that it guarantees efficient outcomes. The proof is seen, for the most part, by noting the choice of framework Hayek adopts to discuss matters pertaining to social philosophy.

The Hayekian framework is made up of a trinity of concepts: liberty (or freedom), the "Rule of Law" (or general rules) and competition, in the sense of free entry and exit. And the existence of these three is conditioned upon the acceptance of a certain moral code.

Of the three concepts, it is liberty which is the most important in Hayek's mind. He has written entire books on the virtues of a Liberal Order. His Constitution of Liberty begins: "We are concerned in this book with that condition of men in which coercion of some by others is reduced as much as is possible in society. This state we shall describe as a state of liberty or freedom."¹

In The Road to Serfdom Hayek's prominent placing of an important quote on liberty once again points to the fact that liberty is the predominant value in his thought.

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F. A. Hayek, The Constitution of Liberty (Chicago, Henry Regnery Co., 1960):11

On the title page of that work he quotes David Hume's timeless message: "It is seldom that liberty of any kind is lost all at once."²

Liberty is not only important, in and of itself, but also for what benefits it provides man. It is liberty, Hayek notes, that gives to civilization its "creative powers"; it is liberty that provides a society with its ability to progress. In the Hayekian scheme of things, progress only occurs when individuals are allowed to make use of the knowledge which they possess for their own purposes. "It is that the case for individual freedom rests chiefly on the recognition of the inevitable ignorance of all of us concerning a great many of the factors on which the achievement of our ends and welfare depends."³ Liberty and progress, then, go hand-in-hand.

The "Progressive Society," properly defined, is equivalent to the "Great Society." It was found that in the "Great Society" the chances of anyone picked at random are as great as possible for meeting one's ends. It is only the society that progresses, however, that can meet this condition of the "Great Society." Hayek states that

² F. A. Hayek, The Road to Serfdom (Chicago, The University of Chicago Press, 1944)

³ F. A. Hayek, The Constitution of Liberty (Chicago, Henry Regnery Co., 1960):29

"the enjoyment of personal success will be given to large numbers only in a society that, as a whole, progresses fairly rapidly."⁴ It is liberty, then, that engenders progress which, in turn, is seen to be necessary for the existence of the efficient order of a "Great Society."

While liberty is a precondition for the "Great Society,": liberty, in turn, is dependent upon a certain condition being met. Before liberty may exist, and the benefits of it realized, a certain moral code must be observed. "It is indeed a truth, which all the great apostles of freedom outside the rationalistic school have never tired of emphasizing, that freedom has never worked without deeply ingrained moral beliefs . . ."⁵

The belief in individual responsibility is one such moral belief. More specifically, "a free society will not function or maintain itself unless its members regard it as right that each individual occupy the position that results from his action and accept it as due to his own action."⁶ It is important to point out here that the concept of responsibility extends beyond the duties exacted by the law. It is, in the Hayekian framework, a moral as well as a legal concept, and as a moral concept, it is

4
Ibid:41

5
Ibid:62

6
Ibid:71

readily and voluntarily self-imposed. For Hayek to be consistent in his evolutionist position, he must show how this moral code emerged. His attempts to do this will be noted later.

II

The "Rule of Law" (or general rules) is also important to the existence of liberty and, through liberty, to the existence and preservation of the "Great Society." Before this is illustrated it is helpful to the discussion at hand to prove that the "Rule of Law" and general rules refer to the same phenomenon. It is a welcome by-product of this discussion that much that is fundamental to illustrating the prominence of the "Rule of Law" or general rules to the working of a "Great Society" will issue forth.

In The Road to Serfdom Hayek notes that "the Rule of Law implies limits to the scope of legislation: it restricts it to the kinds of general rules known as formal law and excludes legislation either directly aimed at particular people or at enabling anybody to use the coercive power of the state for the purpose of such discrimination."⁷ Simply, then, both the "Rule of Law" and general rules refer to a state where the law, not men, rule; and the law is of a certain type; it is general, it possesses certainty and it treats individuals equally.

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F. A. Hayek, The Road to Serfdom (Chicago, The University of Chicago Press, 1944):83

For Hayek, it is only where general rules are applied that efficient orders will emerge because liberty, which is necessary to the generation of efficient emergent orders, is only possible when general rules exist. "There is only one such principle that can preserve a free society: namely, the strict prevention of all coercion except in the enforcement of general abstract rules equally applicable to all."⁸

The link between liberty, general rules and the "Great Society" can be seen in another, less direct, way. Hayek sharply criticizes those existing orders that do not meet the conditions applied by general rules, and therefore not exemplifying a key characteristic of the "Great Society." By viewing Hayek's criticisms of existing orders irreconcilable with applied general rules, one may conclude that only those orders that satisfy the "discipline of general rules" are outside the realm of Hayek's critical remarks and thus, by implication, efficient.

Hayek is most critical of the labor union. Of it he says that "from a state in which little the union could do was legal if they were not prohibited altogether, we have now reached a state where they have become uniquely privileged institutions to which the general rules of law do not apply."⁹

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F. A. Hayek, The Constitution of Liberty (Chicago, Henry Regnery Co., 1960):284

9

Ibid:267

For Hayek, the present characteristics of the labor union, which he holds to be largely coercive in nature, could have only come about because general rules were not observed.

Sharply criticized also are those institutions that seek as their objective "social justice." "It is impossible," Hayek states, "for the Great Society to maintain itself while enforcing rules of 'social' or distributive justice."¹⁰ And on the same subject he notes that "the distributive justice at which socialism aims is thus irreconcilable with the rule of law, and with that freedom under the law which the rule of law is intended to secure."¹¹

Social justice, which Hayek calls "empty and meaningless", and general rules, are mutually exclusive in the sense that "social justice" is an outgrowth of specific, non-abstract rules. There are only two types of rules: specific, non-abstract rules and general, abstract rules. From such different rules, different types of orders arise. Hayek's vehement criticism of "social justice" which, it is repeated, is built upon specific, non-abstract rules can be seen to prove that Hayek must be strictly working within a framework characterized by general, abstract rules when he notes the efficiency of emergent orders. All else calls forth criticism.

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F. A. Hayek, Law, Legislation and Liberty, volume II: The Mirage of Social Justice (Chicago, The University of Chicago Press, 1976):137

11

Ibid:86

III

The third concept which the Hayekian framework emphasizes is competition, in the sense of free entry and exit. Competition can be viewed much the same way liberty was. First, as necessary for the "evolution" of efficient orders and secondly, as dependent upon general rules for its existence.

Addressing the second point first, it is noted that "the functioning of competition not only requires adequate organization of certain institutions like money, markets and channels of information -- some of which can never be adequately provide by private enterprise -- but it depends, above all, on the existence of an appropriate legal system, a legal system designed both to preserve competition and to make it operate as beneficially as possible."¹²

Given the "appropriate legal system," which in Hayek's terminology means that only general rules are applied, competition acts to guarantee that the "widely dispersed knowledge," which is needed for the efficiency of emergent orders, is forthcoming. While speaking of the emergent market order, Hayek states that "it is by this conveying of information in coded form that the competitive efforts of the market game secure the

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F. A. Hayek, The Road to Serfdom (Chicago, The University of Chicago Press, 1944):38

utilization of widely dispersed knowledge."¹³

In this regard, it also provides the choice that is necessary for emergent orders to have "passed the test of time." "Passing the test of time," which Hayek holds to be an indication of the efficiency of an emergent order, only means something if through time competition is present. The absence of competition, which is a result of the removal of general rules, is tantamount to that of granting special privileges; this being the case, the test of time with respect to emergent orders means nothing. It is only competition, itself a by-product of general rules, that gives meaning to the "evolutionary process" through which institutions-orders-outcomes are seen to evolve through time into higher and higher stages."Evolution is likely to lead to beneficial institutions only if competition can select from a variety of different attempts, and all this proceeds among a framework of rules which prevents the use of violence and (suppresses competition developments)."¹⁴

Liberty, general rules and competition, then, are necessary conditions before emergent orders may be considered efficient. In that liberty and competition can

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F. A. Hayek, Law, Legislation and Liberty, volume II: The Mirage of Social Justice (Chicago, The University of Chicago Press, 1976):117

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Personal correspondence with Professor Hayek. Letter dated 28 March 1977.

only exist if general rules do, it may be said, without any loss in truth, that general rules are the necessary and sufficient condition for the emergence of efficient orders. Only in a specified environment, that is, one where general rules are applied, can efficient orders emerge.

Only one issue remains to be looked at. Before general rules can exist a certain moral code needs to be observed. This moral code must place justice over loyalty and by doing so weight general rules over specific rules. If general rules are the precondition for efficient emergent institutions-orders-outcomes, then this moral code is the precondition for the acceptance of the general rules. In this light, those words of J. Ortega y Gasset, which Hayek is so fond of quoting, take on added meaning: "Order is not pressure imposed upon society from without, but an equilibrium which is set up from within."¹⁵

IV

In the sections above, it was shown that Hayek is not an evolutionist in the strict (and true) sense of the word. To be an evolutionist one cannot specify the elements of the **environment** in which the process of evolution is to take place. It stands repeating that if evolution is to mean anything at all it must take place

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F. A. Hayek, *The Constitution of Liberty* (Chicago, Henry Regnery Co., 1960): 148

within an unspecified environment. By specifying the environment which is conducive to the "evolution" of efficient orders, Hayek moves quickly out of the evolutionist camp and at least partially into the constructivist camp.

Hayek may disagree. He may agree that general rules precede efficiency, but then go on to add that general rules emerged. If this were true, it would surely remove Hayek from the constructivist camp. Upon close inspection, Hayek seems to have two contradictory concepts of the "Rule of Law" or general rules. One, he sees them as having emerged and two, he notes that they are a "political ideal." They cannot be both -- emergence precludes something being an "ideal," since emergence is descriptive of what is, while an ideal is descriptive of what is hoped will be.

These two different conceptions of general rules that Hayek has need to be specifically noted. Hayek both explicitly and implicitly refers to the emergence of the "Rule of Law" or general rules. He oftens speaks of "finding" or "discovering" "the law," thus implying that it is emergent law that is being spoken of since constructed law would not need to be "found" or "discovered." Specifically, he notes that "though in the long perspective of Western civilization the history of law is a history of a gradual emergence of rules of just conduct capable of

universal application," (that is, general rules), "its development during the last hundred years has become increasingly one of the destruction of justice by 'social justice,' until even some students of jurisprudence have lost sight of the original meaning of 'justice'".¹⁶ He adds that "though the naive constructivist interpretation of the origin of social institutions tends to assume that the rules of law must be the product of somebody's will, this is in fact contrary to actual development and just as mythical as the origin of society from a social contract."¹⁷

It is when Hayek speaks of the "Rule of Law" or general rules as a "political ideal" that he comes closer to the true nature of things. He notes that "the rule of law is therefore not a rule of law, but a rule concerning what the law ought to be, a meta-legal doctrine or political ideal."¹⁸ Similarly, he states that "many of the applications of the rule of law are also ideals which we can hope to approach very closely but can never fully realize."¹⁹ It is difficult to see how law which

¹⁶ F. A. Hayek, Law, Legislation and Liberty, volume II: (Chicago, The University of Chicago Press, 1976):135

¹⁷ Ibid:41

¹⁸ F. A. Hayek, The Constitution of Liberty (Chicago, Henry Regnery Co., 1960);206

¹⁹ Ibid:207

"we can hope to approach . . . but can never fully realize" can also be existing emergent law. Fact is, it cannot. A possible, but unlikely, explanation for this is that Hayek holds the view that general rules existed at a former time in history, but because of the interferences by "law-making" bodies now are relegated to remaining simply a "political ideal." Time, then, is what separates general rules as emergent law from that of being a "political ideal."

It would seem reasonable, though, that the "correct" environment, not time, is the necessary condition for general rules to exist. What once was can be again if conditions are made to be the same. The "decline of the rule of law" can be reversed if that which led to its decline is removed.

The "correct" environment for the emergence of general rules is dependent upon that which both liberty and competition, and, in turn, the "Great Society" were earlier noted to be dependent upon - - namely, a certain moral code. General rules can only emerge if the strong "emotions of the tribal society" are warded off by the observance of the moral code that places (abstract) justice over (concrete) loyalty, thus prohibiting all privilege. To address a specific issue, holders of this moral code must accept as sacrosanct the dictates of the "marketplace," whether they are in one particular instance favorable or

unfavorable to them. Recent years have certainly not seen the observance of such a moral code --witness special interest groups, many of which would not exist if privileges were not being granted them.

It is not impossible that general rules would emerge; simple observation, however, is good proof that they do not exist at present. They are only a "political ideal" because the moral code that is necessary for their existence is not being observed. Later chapters will discuss the reasons for this.

Perhaps Hayek's work in social philosophy can be seen as a means of inspiring people into observing the moral code that will ultimately "produce" the general rules that are necessary for the smooth workings of the "Great Society." Perhaps inspiration is the only thing that can cause people to "reason out" many of their most basic feelings with respect to themselves and others and thus accept the discipline required by general rules.

CHAPTER V
NON-TELEOLOGICAL CONSTRUCTION

As evidenced in Chapter IV, Hayek, by specifying the environment in which institutions-orders-outcomes emerge, is not an evolutionist in the true sense of the word. Neither is he a constructivist if by that word it is meant one who constructs, designs, models things in such a way that a specific end or end-state is produced. Hayek does not seek a specific end, he rather seeks to bound the set of possible ends. He specifies what cannot exist, not what will exist. If for example, end-states A-Z may exist (and no others), Hayek is specifying that end-states D-Z may not exist, not that end-state A will exist. Hayek then is not as much of a constructivist as one who specifies a specific end, but he is a constructivist in the sense that he specifies, he simply specifies what cannot be. And largely it the act of specification that determines whether one is a constructivist or not.

For the sake of clarity, however, a distinction between the two types of construction heretofore mentioned needs to be noted. Construction of the type Hayek undertakes shall be called "non-teleological construction"; the other, "teleological construction." Hayek is, then, in no contradiction of terms, an antirational non-teleological constructivist.

Among other well-known social philosophers, John Rawls, too, may be seen to be a non-teleological constructivist. Rawls, in A Theory of Justice, puts forward his theory of "justice as fairness." Justice as fairness is a theory of justice dependent upon certain initial conditions being met. More specifically, it is dependent upon the original position Rawls constructs. Rawls states:

In justice as fairness the original position of equality corresponds to the state of nature in the traditional theory of the social contract. This original position is not, of course, thought of as an actual historical state of affairs, much less as a primitive condition of culture. It is understood as a purely hypothetical situation characterized so as to lead to a certain conception of justice. Among the essential features of this situation is that no one knows his place in society, his class position or social status, nor does any one know his fortune in the distribution of natural assets and abilities, his intelligence, strength and the like. I shall even assume that the parties do not know their conceptions of the good or their special psychological propensities. The principles of justice are chosen behind a veil of ignorance. (1)

Having set up the original position, Rawls goes on to predict what will emerge from it. In doing so, he goes further than does Hayek. Hayek does not predict

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John Rawls, A Theory of Justice (Oxford, Oxford University, 1971):12

what will emerge, he only notes what will not emerge. As stated earlier, Hayek only specifies a range of possible ends or end-states.

Rawls maintains that persons in the original position (that is, behind the veil of ignorance) will choose two principles of justice: "the first requires equality in the assignment of basic rights and duties, while the second holds that social and economic inequalities, for example inequalities of wealth and authority, are just only if they result in compensating benefits for everyone, and in particular for the least advantaged members of society."²

Rawls's two principles of justice are conditioned upon the existence and specific definition of the original position. Nozick notes that the second principle of justice, commonly referred to as the "difference principle", is especially conditioned upon the original position. For Nozick, "no historical principle, it seems, could be agreed to in the first instance by the participants in Rawls's original position. For people meeting together behind a veil of ignorance to decide who gets what, knowing nothing about any special entitlements people may have, will treat anything to be distributed as manna from heaven."³

Rawls, then, constructs these two principles of justice in that he prohibits all possible principles that

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Ibid:14-15

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Robert Nozick, Anarchy, State and Utopia (New York, Basic Books Inc., 1974):199

would not meet the conditions set up in the original position. He, like Hayek, may thus be considered a non-teleological constructivist.

Non-teleological construction is to be found in areas other than the works of Hayek and Rawls. For instance much of the law exhibits the central characteristic of it. Not all law (law here is being used to refer to both long-standing rules and to legislation) is of the type where a specific action-outcome is imposed. Some law, instead of imposing a specific end-result, only prohibits certain end-results, in the process allowing any number of possible end-results to come about. Law that states what one cannot do is rather more flexible than law that states what one must do. The first type of law is a further example of non-teleological constructivism.

With this in mind, further emphasis can be given to Hayek's being a non-teleological constructivist. He states "that practically all rules of just conduct are negative in the sense that they normally impose no positive duties on any one, unless he has incurred such duties by his own actions, is a feature that has again and again, as though it were a new discovery, been pointed out, but scarcely ever systematically investigated."⁴

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F. A. Hayek, Law, Legislation and Liberty, volume II: The Mirage of Social Justice (Chicago, The University of Chicago Press, 1976):36

Hayek and Rawls are not alone in their advocacy of non-teleological construction. Others, too, have attempted to bound the set of possible ends or end-states. Adam Smith was one in particular who realized that "undirected evolution" would bring with it many undesirable results. Those benefits of a "free market" which Smith has so eloquently noted can only come forth when man lives under suitable "laws and institutions."⁵ In the absence of proper "laws and institutions" Smith felt something like Hobbesian anarchy, with all its implied waste, would result.⁶ In that Smith had an institutional framework in which he worked, that is, in that he did not trust the "forces of nature" to bring desirable results, he, too, can be labeled a non-teleological constructivist. He denied some end-states the description of desirability and efficiency because they did not come about through a process that was under the shadow of certain "laws and institutions."

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See Nathan Rosenberg, "Some Institutional Aspects of The Wealth of Nations", Journal of Political Economy, 68, December 1960:557-570

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"It is with the Hobbesian view that most economists, from Adam Smith onwards, have begun. What has impressed them most in it is the sheer waste involved in a state of anarchy -- waste by those who undertake the effort of stealing -- and by others who use more resources for their own defense." E. G. West, "Smith's Economics of Politics," History of Political Economy 8:4, 1976:516

It is being noted, then, that Smith, when he speaks of the virtues of a "market order" is assuming the "market order" to be of a certain type -- one in which proper "laws and institutions" are present. Buchanan has noted the point well by denying that Smith is the historical analogue to a present Murray Rothbard.⁷

Smith's "laws and institutions", Hayek's general rules and Rawls's original position, are all attempts at non-teleological construction. One step further back, however, they can be seen to be attempts at limiting, in an institutional manner, certain considered "bads." The work of James Buchanan can also be seen in this light, and in that it is, he, too, may be considered a non-teleological constructivist. Professor Buchanan's approach may be seen as offering a desirable position between the undesirable extremes "produced" by the evolutionary process, that is, from the subtitle of one of his books, "between anarchy and leviathan."

Buchanan is a contractarian and as a contractarian he puts emphasis on the process that generates certain outcomes and not on the outcomes themselves. For him, "evaluating" outcomes outside of the process that generated them is meaningless in the sense that it omits from view and

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James M. Buchanan, "The Justice of Natural Liberty," The Journal of Legal Studies, volume V (1), January 1976: 1-16

assessment the "development" of the outcome. In other words, to only note the outcome is to only see part of the picture, and good economic analysis must be more complete than this. Buchanan would also not "evaluate" outcomes outside of the process that generated them, for to do so, would be tantamount to "playing God." Essentially, it is imposing one's value-judgments on a situation. That outcome is desirable which meets one's particular standards, or criteria for desirability. This position either ignores or relegates to an inferior position those persons that may have chosen the outcome in question. Their preferences, their values, then, account for nothing. Only the preferences and values of the one who "evaluates" the outcome account for anything. It is this egocentric position that Buchanan wants to stay away from that causes him to place emphasis on the process rather than the outcome. Buchanan's approach is "individualistic, in an ontological-methodological sense . . ." ⁸ For him, "each man counts for one, and that is that." ⁹

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James M. Buchanan, The Limits of Liberty: Between Anarchy and Leviathan (Chicago, The University of Chicago Press, 1975):1

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Ibid:2

This approach does, of course, have inherent within it a certain, broadly-defined "value-judgment."¹⁰ Buchanan's position does, after all, make a statement on what is "good." "A situation is judged "good" to the extent that it allows individuals to get what they want to get, whatsoever this might be, limited only by the principle of mutual agreement."¹¹ Similarly, Buchanan elsewhere notes that "my natural proclivity as an economist is to place ultimate value on process or procedure, and by implication to define as "good" that which emerges from agreement among free men, independently of intrinsic evaluation of the outcome itself."¹²

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It could be reasonably argued that it does not. After all, the value-judgment there is that which is "good" (hence the value-judgment) is to allow each individual to count for one, and recognize that one's own preferences and values are not superior, nor inferior, to anyone else's. Some would argue that this position does not issue forth a value-judgment. This is true if value-judgment is defined a certain way. If noting that one's preferences and values are no better nor no worse than anyone else's is not a value-judgment, but simply a statement, then that is that. If, however, a value-judgment is said to have been made when anything is preferred over anything else, then the above position does constitute one of issuing forth a value-judgment. In either case, it would seem reasonable to assert that if the Buchanan position does make a value-judgment, it certainly is a weak one.

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James M. Buchanan, The Limits of Liberty: Between Anarchy and Leviathan (Chicago, The University of Chicago Press, 1975):2

12

Ibid:167

This is the mark of a contractarian. A contractarian will place "weight" or "value" on that which has been agreed to by free individuals. Buchanan differs in one key respect, however, from the contractarian mentioned earlier, John Rawls. As noted, Rawls predicts the principles of justice that would emerge from the original position. Buchanan does not do this. He does not try to predict what will emerge out of an idealized contractual setting, or any other type for that matter. In that he has not extended himself to the extent Rawls has, he may be considered less of a non-teleological constructivist than Rawls. For Rawls, that which has met his two principles of justice, is just. For Buchanan, that which has emerged out of a contractual setting between free individuals may be considered just. For pedagogic purposes, Rawls's definition of justice may be considered narrower than Buchanan's for the simple reason that Rawls takes it upon himself to predict the principles of justice, and Buchanan does not. This, of course, does not deny the fact that Buchanan is a non-teleological constructivist. He is to the extent that he works within a certain framework. It is a contractual framework, and within it, that which "emerges" is to be considered "good." Buchanan constrains, to a degree, the possible end-states that may be considered "good." An outcome must have been contracted for by free individuals or, at least, hypothetically been contracted

for, before it can be considered "good" or "efficient."
Any outcome having "emerged" outside this framework is not likely to be either "good" or "efficient."

This tendency on the behalf of the noted economists and social philosophers above to construct non-teleologically, may be seen to be an outgrowth of knowledge, in general; or specifically, a deepened understanding of causal-effect relationships. When it is learned that X will lead to Y and Y is undesirable, then there is an inclination to prevent Y, by prohibiting X. Smith's "laws and institutions" are means to prevent the inefficiencies and chaos of anarchy, while Buchanan's "contractual setting" and constitutional attitude that it implies, may be seen as a way to prevent the dilemmas of social evolution. Similarly, Rawls's "principles of justice" is an attempt at circumventing the "injustice" of utilitarianism, while Hayek's "general rules" seek to eliminate the power and arbitrariness of government.

CHAPTER VI
UNDESIRABLE EMERGENT OUTCOMES

The study of the efficiency properties of institutional evolution is far from complete. So far, the Hayek position has been expounded and it has been noted that the position holds only when the environment is specified to be one where general rules are applied. Attempts will now be made to point to some of the "unintended consequences of human action" that result within unspecified environments. Most notably, two outcomes, inflation and big government, which few persons intuitively feel have emerged, will be shown to have done just that. The reader should take note that the following discussion is designed to make the point about evolution; it make no claims at all to offering substantive "explanations" of either inflation or big government.

I

Inflation is an emergent outcome; it is an "unintended consequence of human action", and it is, by most everyone's account, an inefficient outcome.

Inflation emerges out of a certain order, more specifically, a certain "political" order. It is an order characterized by politicians competing for votes in the absence of a monetary constitution. Here, competing

politicians, as vote maximizers, will, for the most part, favor increased government expenditures. Given the present state of mind of most voters, the evolutionary process will "choose" those politicians to be successful in their attempts at being elected and re-elected to political office.¹

The increased government expenditures that are called for by numerous politicians are not to be tax-financed, since the same politicians have learned that this method of financing expenditures loses votes. Evolution has eliminated the politician who thinks otherwise. If increased government expenditures are not tax-financed, the result is a budget deficit; therefore, politicians in their open advancement of increased government expenditures argue (perhaps unknown to most of them) for budget deficits.

Once the option of tax-financing government expenditures is removed, there are two remaining ways to finance the deficit: it may either be bond or money financed. Between these two choices, politicians have increasingly turned to money-financing budget deficits, perhaps due in large measure to the belief that an increase in the money supply will lower short run interest rates. At times this is another political plus. In any case, the result of money-financing budget deficits is, in most cases, inflation.

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For a book that discusses the consequences of a political democracy, see James M. Buchanan and Richard E. Wagner, Democracy in Deficit: The Political Legacy of Lord Keynes (Academic Press, 1977)

Thus given the present state of the environment, evolution "chooses" those politicians that will, by their actions, "produce" inflation.

One of the main characteristics of an emergent institution-order-outcome is that it is "spontaneously" generated out of the actions of individuals. It appears without anyone, in most cases, and with only a few persons, in some cases, expressing an open desire for it. It appears almost as magically as does the rabbit out of the magician's tophat. And such is the case with inflation. Few persons express a desire for it, and it does seem to appear unexpectedly.

Another characteristic of an emergent institution-order-outcome is that its cause is unlikely to be seen or understood by many persons. This is largely a result of the magical quality with which it seems to appear. Just as persons question from where the magician's rabbit appeared, so they question the cause of inflation. In their quest for an answer to inflation's cause, they attribute it to a number of different things --- unions, big business, OPEC --- largely guessing at the cause in the process. Such would not be the case with a constructed outcome -- its birthplace is easily seen and fully understood.

It should be noted here that an outcome, any outcome, emerges out of an environment. Furthermore, the evolutionary

process will "choose" those actions of individuals (which go to "make" the outcome) which are most consistent with the given "state of the environment." In the case of inflation, the evolutionary process "chose" those politicians that favored increasing government expenditures by means of printing money. Given the "state of the environment" it was these politicians that were successful. Looking at it from a different angle, it was only these politicians that could have been successful given the "state of the environment." And evolution, it should always be remembered, is only concerned with the successful. In a very real sense, the "failures" do not even exist.

Successful politicians need neither understand nor be concerned with the fact that their actions generate inflation. They need only know what gets them elected or re-elected. In the political market, as in the goods market, those politicians that sell those services that the voting public demands will get their services purchased, and they will determine the resulting outcome. Evolution is not concerned with issues of "right" or "wrong"; neither is it concerned with what is "moral" or "immoral", it is simply concerned with the successful (however it came to exist), and the successful, while it changes from time to time, is always defined with respect to the "state of the environment."

As hinted at above, the "state of the environment" in a political market is composed of the ideas, beliefs

and actions of the voting public. The voters, acting in their self-interest, will have little incentive to understand that increased government expenditures that are money-financed are inflationary. In a large-numbers setting each voter sees the cost as high, relative to the benefit, of becoming informed. Ignorance is chosen, and it is a perfectly rational course of action to take here. Finding it of little use to either become informed or understand matters of economic policy, voters will do in the political market what they do in the goods market, that is, they will vote for the individual who offers them the most (in terms of goods and services) for as little payment as possible. The result: money-financed budget deficits that cause inflation.

A related issue concerns special interest groups. Special interest groups, unlike the general voter, have an incentive to stay informed on matters of economic policy that relate to them. Politicians understand this. They will recognize that responding to those individuals (in the form of special interest groups) that will reward or punish them according to their actions is to be preferred to responding to those that are choosing to stay uninformed on what is happening, and consequently not as likely to reward or punish them. And the politician's response to special interest groups is most likely to take the form of government spending on their behalf.

It should be noted in passing that the members of a special interest group may not know that their actions are, in an indirect way, part of the cause of inflation. Whether they know that they are or not is irrelevant to the issue at hand. The course of action will always be the same. As will be shown later, those special interest groups that do lobby for increased government expenditures will have a better chance of being successful and enduring. They are, therefore, the only ones that count with respect to the outcome.

A discussion of inflation is not complete without mention of the Federal Reserve Board. The Fed, by money-financing the deficit, gives its stamp of approval to the inflationary actions of the voting public and competing politicians. In this sense, the Fed is a participant in the emergent outcome of inflation.

There is one difference, however, between the Fed and other participants. There is some indication that the Fed is aware that money-financed budget deficits cause inflation. In that it follows an inflationary monetary policy with this knowledge at hand, it can be said that the Fed openly and directly chooses inflation. This is not the case for most voters and politicians.

Explanations have been given for this behavior on the part of the Fed. Most individuals put the Fed's desire

to maintain long-run independence at the center of the explanation. In an environment where politicians often-times threaten to reduce or to eliminate the independence of the Fed, the long-run independence of it can only be maintained through meeting the desires of those politicians. This takes the form of money-financing budget deficits.

The fact that the Fed continues to respond to budget deficits in an inflationary manner does not remove inflation from the emergent outcome category. The Fed did not construct inflation, it simply made a cost-benefit calculation with respect to it and their long-run independence and decided to permit its existence. The seed of inflation is planted far deeper than the level of the Fed.

II

One of the issues touched on above was that of special interest groups. It was stated that special interest groups, irrespective of their understanding of the cause of inflation and their part in it, will lobby politicians for increased government expenditures. This is a rational action, and it is this rational behavior on the part of special interest groups that is the explanation for another emergent outcome --- big government.

Special interest groups act rationally when they ask favors of government, whether these favors be in the form of increased government expenditures or in some form of a privilege. This is rational to the extent that if one

group does not lobby for a government favor other groups will, thus reducing its relative position by widening the gap between itself and others.

This situation can be seen in terms of a subsidy and a tax. The granting of a government favor to group A can be seen to be a subsidy and depending upon the amount of overlap between groups, a subsidy to one group acts as a "tax" on another group. When domestic clothing manufacturers receive economic protection in the form of a quota being placed on foreign clothing imports, they are receiving a subsidy, while to the consumers who without the quota would have paid lower clothing prices, it is a "tax."

The situation progresses to the point where groups, simply in order to maintain their relative positions, must continuously seek government favors. Special interest groups find themselves in a generalized prisoners' dilemma situation; so long as one group seeks government favors, it is in the best interest of others to do the same, even though the probability is great that in the long-run all will be made worse off. Also, as groups continue to seek government favors, the number of groups increases and consequently quickens the process at work here. A result of this process is increased government programs and government personnel, that is, big government, with its connotation of increased power and control over the lives of men.

Big government, then, as inflation, is an emergent outcome. Both emerged in an unspecified environment, the only type of environment in which "emergence" has any meaning. Both are the result of the rational, self-interested actions of individuals.

Hayek would probably deny that big government and inflation are emergent outcomes; after all, as was pointed out earlier, Hayek implies emergent outcomes to be efficient. He would probably see both as the result of continued "interference" with a spontaneous order; he would probably note that both are the results of construction.

But as mentioned before, Hayek's view of inflation and big government as having been "constructed", and therefore inefficient, is dependent upon his view of the environment in which efficient outcomes emerge. Here circularity can possibly be attributed to Hayek, at least by implication. He defines the appropriate environment for the evolution of efficient outcomes by looking at the end product. This, of course, leads to a bias with respect to institutional evolution. After all, some emergent outcomes are better than others.

III

Inflation and big government are not the only undesirable consequences of human action. Others abound.

For example, T. C. Schelling notes that "complete segregation" (say between whites and blacks) can be seen as part of an invisible hand process and that it does not represent a desirable outcome as measured by the preferences of the segregated individuals. "My conjecture is that the interplay of individual choices, where unorganized segregation is concerned, is a complex system with collective results, that bear no close relation to individual intent."²

Suppose that both whites and blacks want integration, but each wants a special type of integration -- partial integration -- where this means that each group wants to live in an area with the other group, but whites want to be at least three-fourths of the population and blacks at least one-third. Given these preferences, the objective will never be met. In their attempts to satisfy their preferences, both groups will find that they are unable to have the type of integration they desire. Whites in their desire to be three-fourths of the population will move to areas where this requirement is met, thus eliminating the chance for blacks to occupy one-third of the population. Consequently, blacks will move towards neighborhoods that are more than one-third black. It can be seen from this, then, that the outcome is complete segregation, an outcome that is undesirable as compared to the outcome of

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T. C. Schelling, "Models of Segregation", American Economic Review, 54, May 1969:488-93

partial integration. The same outcome would also be forthcoming if each group, white and black, wished only to be a simple majority of the neighborhood.

This example brings out a distinction between an outcome being efficient and being desirable. The two terms are not necessarily synonyms and this needs to be noted. An outcome may be efficient and desirable or it may be efficient and undesirable. For instance suppose in the example above that both whites and blacks preferred complete segregation over partial integration. This being the case, the outcome of complete segregation would be desirable as measured by the preferences of the individuals concerned. The outcome would also be efficient in that it would not be possible to make one person better off without simultaneously harming a second person. In this case, then, the outcome is efficient and desirable.

Suppose, however, that the situation is the one discussed earlier, where partial integration was preferred to complete segregation. The outcome would still be complete segregation, though. It is noted that the outcome is the same irrespective of the difference in preferences between the two cases. The outcome in the latter case, however, is undesirable in that there exists a preferred outcome --- partial integration is preferred to complete segregation. The undesirable outcome is nonetheless efficient.

Outside of a miracle, there is no possible rearrangement such that one person could be made better off without a second person being made worse off.

An outcome, then, may be efficient but not desirable (except in the case where one feels that an outcome is desirable if it is the "best" that can come about given the circumstances). It has been noted that it is meaningless to speak about something as being undesirable if it is efficient, that is, the "best" that can be given the circumstances. This may be true if the objective is simply to change outcomes in a Pareto-efficient manner; it is untrue when the process that generates undesirable outcomes is being studied. And this is what is being done here. It does not seem a useless exercise to note that an outcome may be the same between two sets of differently ranked preferences. To simply note this phenomenon and to label it would seem to add to understanding.

IV

Professor Buchanan's, hypothetical but probably empirical, example of a "littered beach" is an outcome that emerged, and given a certain set of preferences, may be considered an undesirable outcome. The littered beach results from the fact that in a large numbers setting

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James M. Buchanan, "Law and the Invisible Hand," Freedom in Constitutional Contract: Perspectives of a Political Economist (College Station and London, Texas A & M University Press, 1977)

especially, and in a small numbers setting to a lesser degree, an individual undertaking actions does not normally feel the full benefits or costs of his actions. This discrepancy between benefits and costs -- which is simply a manifestation of the nonspecification of property rights -- generates certain negative externalities.

In the littered beach example, individuals would not hesitate to litter the beach since each individual would, in such a setting, note that the cost of placing his litter in a trash container would be greater than the benefits he would receive from doing so. The benefits are negligible (in relation to the costs) since each individual would think that his littering would not be sufficient enough to turn an unlittered beach into a littered beach. The result of this way of thinking and acting would, of course, be a littered beach. And the littered beach is an undesirable outcome as measured by the preferences of the individuals on the beach. It is essential to note that in this case, as in the case of complete segregation above, the outcome is the same irrespective of preferences. Whether individuals desire a littered beach or not, a littered beach will be the outcome. For instance, if all individuals on the beach preferred a littered beach to an unlittered beach, then, of course, each individual would litter and a littered beach would

result. But even if individuals preferred an unlittered beach to a littered one, a littered beach would result as long as individuals were undertaking the type of cost-benefit calculation noted above. (There seems to be no evidence that they do not. It is possible that the costs of littering to the individual may go up perhaps through individuals beginning to equate the act of littering with an act of social impropriety. This, however, is a change in one's utility function and outside the purview of this discussion. It is no insight to note that results will be different if individuals' utility functions are different.)

The littered beach, then, may be seen to be the result of an invisible hand process. The actions of individuals go to "produce" an outcome that individuals, in taking their actions, did not anticipate and in this case, did not desire.

V

If it were true that all emergent outcomes were desirable and-or efficient, then there would not be attempts on the part of individuals affected by the outcomes to change them. Attempts at change indicate less than complete satisfaction.

It is in this light that Alchian and Demsetz's "theory of the firm" may be seen as essentially a recognition of this fact. Alchian and Demsetz's theory of the firm represents an attempt by individuals to construct

themselves out of an undesirable and inefficient emergent outcome.

Individuals realizing the synergetic quality of team activity in production decide to form a team and split the increase in product that results from team activity.

" . . . there is a source of gain from cooperative activity involving work as a team . . ."⁴

Team activity is not without its costs, however. With team activity comes the problem of effectively monitoring the team members. The situation is one where "each input owner will have more incentive to shirk when he works as a part of a team, than if his performance could be monitored easily or if he did not work as a team."⁵

There is, then, both an unintended and an intended consequence of team activity. The intended consequence is that there is an increase in output; the unintended consequence is that there is an increase in shirking, which acts to decrease the increase in output that is a result of the formation of the team.⁵ This can be explained as

⁴ Armen A. Alchian and Harold Demsetz, "Production, Information Costs and Economic Organization," American Economic Review, 62, 1972:777

⁵ Ibid:780

a result of rational behavior.⁶

The increased incentive to shirk that accompanies team formation can be seen to be an undesirable and inefficient outcome. In the Alchian and Demsetz "theory of the firm", as long as the costs of increased monitoring (to decrease the shirking) are not so high as to eliminate the benefits of team activity, then team members will find it in their best interest to "construct" themselves out of the position they now find themselves in. "If there is a net increase in productivity available by team production, net of metering cost associated with disciplining the team, then team production will be relied upon rather than a multitude of bilateral exchanges of separable individual outputs."⁷

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"Both leisure and higher income enter a person's utility function. Hence each person should adjust his work and realized reward so as to equate the marginal rate of substitution between leisure and production of real output to his marginal rate of substitution in consumption. That is, he would adjust his rate of work to bring his demand prices of leisure and output to equality with their true costs. However, with detection, policing, monitoring, measuring or metering costs, each person will be induced to take more leisure, because the effect of relaxing on his realized (reward) rate of substitution between output and leisure will be less than the effect on the true rate of substitution. His realized cost of leisure will fall more than the true cost of leisure, so that he "buys" more leisure (i.e. more nonpecuniary reward). Ibid:782

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Ibid:780

The unintended consequence of team activity --increased shirking -- can be seen to have originated in much the same way as did Buchanan's "littered beach." In both cases, the divergence between private and social costs (or between the realized and actual costs) generated a negative externality which may be viewed as undesirable by all parties concerned.

VI

Alchian and Demsetz's "theory of the firm" is not the only instance where an attempt has been made to eliminate a certain undesirable and inefficient outcome. Paul Rubin when discussing the present-day franchise contract notes that it takes the form it does because it was constructed so as to guarantee a certain desirable result, or alternatively, to prohibit a certain undesirable result.⁸

After dismissing the capital market explanation of franchising as unsatisfactory, Rubin purports that "franchising is usually undertaken in situations where the franchisee is physically removed from the franchisor and thus where monitoring the performance and behavior of the franchise would be difficult."⁹

⁸ See Paul Rubin, "The Theory of the Firm and the Structure of the Franchise Contract", Journal of Law and Economics, 21, April 1978:223-34

⁹ Ibid:226

Here, however, where there exists an incentive to shirk, the franchisee and franchisor have room to gain by devising a means to prevent excessive shirking. Of course the obvious way to do this is to give the franchisee a part of the profits of the franchise. But with only a part of the profits there would remain some "residual shirking." This being the case, it would seem that the only way to eliminate shirking (or the excessive consumption of leisure) on the part of franchisees is for them to be given the full profits of the franchise. But if this were the case, the franchisee would then realize that now the franchisor has an added incentive to shirk, and this is something that is harmful to him.

The franchisee, by initially buying the franchise, purchases a trademark which is valuable because it is immediately recognizable by the public and imparts to it certain relevant information with respect to the good being sold. The trademark which franchisees are buying will mean less over time if it is not the case that the franchisor has a part of the profits. In this case, it is the objective of the franchisor to maximize profits, in the process he must take actions to prevent the trademark from deteriorating in the eyes of the buying public. A deterioration of the trademark would likely result if the franchisor did not share in the profits, for then he

would have little reason to "monitor" the behavior of franchisees. Each franchisee would then have an incentive to let the quality of his product decline since he would not share the full costs of his action. "What is involved is a classic externality problem. If any one franchise allows quality to deteriorate, he will generate revenue because consumers perceive him as being of the same quality as other stores with the same trademark. Thus if one franchisee allows the quality of his establishment to deteriorate, he benefits by the full amount of the savings from reduced quality maintenance; he loses only part of the costs, for part is borne by other franchisees. All franchises would lose something as a result of this deterioration in one franchise: consumers would have less faith in the quality promised by the trademark."^{10,11}

In order to effectively maintain quality the franchisees and the franchisor would be interested in franchise contracts that call for easy termination of franchises.

¹⁰ Ibid:229

¹¹ This situation is reported to be true by Ray Kroc, modern founder of McDonalds. He reports in his book, Grinding It Out how, in the early days of McDonald's history, franchises were reducing the quality of the good they sold: "In many of them the quality of the hamburgers was inferior, because they were grinding hearts into the meat and the high fat content made it greasy." Ray Kroc, Grinding It Out: The Making of McDonalds (Berkley Publishing Corp., 1977):113

It is this that makes it possible to avoid quality and trademark deterioration. The specification of the franchise contract such that the franchisor and the franchisee both share in the profits is an attempt to prevent that which naturally emerges through the actions of individuals. Specifically, trademark deterioration and excessive shirking would naturally emerge if there were not a conscious attempt to prevent it. The franchise contract in its present form can be seen as a means to do just that. "Giving the franchisee a large share of the profits of the operation creates an incentive for him to be efficient in that part of the operation he can most efficiently control; giving the franchisor a share of the profits all franchises gives him an incentive in those aspects of the enterprise under his control. Both parts of the contract can be understood as an attempt to give property rights to the parties to the transaction in those areas they can efficiently control."¹²

The undesirable circumstances cited here and in the above cases are, of course, all representative of the generalized prisoners' dilemma case, where strategic actions on the part of individuals lead to outcomes that are

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Paul Rubin, "The Theory of the Firm and the Structure of the Franchise Contract", Journal of Law and Economics, 21, April 1978:229

undesirable and inefficient. To dispute the existence of inefficient and undesirable unintended consequences of human action is to doubt that the prisoners' dilemma situation is representative of much that exists. This position, then, would lead one to either deny the existence of prisoners' dilemma outcomes, or to give an explanation other than the aforementioned one for how and why prisoners' dilemma outcomes come to exist. The explanation would have to be versed in terms of prisoners' dilemma outcomes being brought about intentionally by the actions of individuals, since denying the explanation above implicitly leads to the denial of the "unintended" characteristic of them. Such an explanation would be saying that prisoners' dilemma outcomes, which are non-optimal, are chosen. This is a difficult position for one to hold since it upsets the widely held view that individuals seek to maximize utility. One cannot both maximize utility and choose a prisoners' dilemma outcome, since the two are mutually exclusive. It is possible, however, that one may be led to a prisoners' dilemma outcome (that is, not directly choose it) and be a utility maximizer too. This seems the more reasonable position since there is no good evidence that individuals do not maximize utility, but plenty of evidence that they do.

CHAPTER VII
LIMITATIONS OF THE EVOLUTIONARY PROCESS

Two related issues will be discussed in this chapter. First, a recent contribution to the literature concerning emergent institutions-orders-outcomes will be discussed. Robert Nozick's Anarchy, State and Utopia presents the argument that the minimal state is a result of the invisible hand process. With this in mind, the question of whether the invisible hand process is capable of generating the minimal state needs to be asked and answered.

Once this question is answered, a more general question needs to be asked: What specifically is the evolutionary process capable of "producing" in terms of institutions-orders-outcomes?

I

Nozick's starting point is the "state of nature." After a brief description of the state of nature, Nozick notes that there are certain "inconveniences of the state of nature" that will be attempted to be avoided by persons.

A means of avoiding or preventing these "inconveniences", says Nozick, is for an individual to join a protective association. Protective associations offer individuals a means to protect themselves and their property. Individuals

will choose to be part of a protective association because it is in their best interest to do so. The result of such self-interested behavior on the part of individuals is that a number of protective associations come about, some locating in the same geographical area. This is an unintended outcome. No one planned that there would be a number of protective associations; this result simply emerged.

There are numerous analogues in every day life to this situation. For instance, no one plans that there will be a number of different clubs at any one point in time. Neither does any one plan that there will be different types of department stores, neighborhoods, political parties, or movie theaters. Outcomes that are descriptive of these situations simply come about through the self-interested actions of individuals.

Nozick, too, notes the outcome represented by a number of protective associations existing simultaneously as an emergent outcome. In Nozick's terminology, borrowed from Adam Smith, it is a result of an invisible hand process. Not only does Nozick give an invisible hand explanation for the set of protective associations, he goes one step further. He explains the rise of one dominant protective association in terms of an invisible hand process.

With existing protective associations there is competition, just as there might be between clubs, department stores,

and movie theaters. Here, however, the competition leads to a different result than in the case of clubs, department stores, and movie theaters. As Nozick has noted of this case: "the worth of the product purchased, protection against others, is relative: it depends upon how strong others are. Yet unlike other goods that are comparatively evaluated, maximal competing protective services cannot coexist; the nature of the service brings different agencies not only into competition for customers' patronage, but also into violent conflict with each other. Also, since the worth of the less than maximal product declines disproportionately with the number who purchase the maximal product, customers will not stably settle for the lesser good, and competing companies are caught in a declining spiral."¹

These facts lead to the conclusion that there can only be one protective association. This one dominant protective association emerges. Individuals will be drawn to the most effective protective association since doing anything short of this will not provide them with the service they demand from a protective association. Anything less than choosing the most effective protective association is very similar to not choosing a protective association at all, that is, it is a decision to live with the "inconveniences of the state of nature."

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Robert Nozick, Anarchy, State and Utopia (New York, Basic Books, Inc., 1974):17

Two things need to be noted. First, Nozick is correct in saying that the dominant protective association is a result of an invisible hand process. It does emerge out of the situation where there are a number of competing protective associations. Nozick's rationale for the dominant protective association ("the worth of the product purchased, protection against others, is relative") may be seen to be part of the self-interested actions on the part of individuals that generates it. Just as individuals in a barter system will find it beneficial to employ in market transactions those commodities that are more marketable than others, individuals in the state of nature will find it beneficial to purchase the services of those protective associations that are more effective than others. In the first case, there is a move by individuals towards the most marketable good, and it is this good, then, that becomes money. In the second case, there is a move towards the most effective protective association, and it is this protective association that becomes the dominant one. In both cases, there is a tendency to converge on one item. The nature of the service that is being sought by individuals makes this so.

Secondly, it should be noted that the emergent outcome represented by a number of different protective associations is not efficient, since there is a move away from it and

towards one dominant protective association. Nozick, here, implicitly seems to be saying that emergence does not necessarily mean efficiency, a point that is agreed upon.

So far, Nozick's analysis of the state has been straightforward. There is little doubt that Nozick is correct when he notes that the dominant protective association is a result of an invisible hand process. It is when he goes further and refers to the next outcome of the "evolutionary process" -- the minimal state -- as having emerged that he commits an error.

For Nozick the minimal state emerges in the same way as did the one dominant protective association. The major difference between the two, however, is that the minimal state contains some form of redistribution, while the dominant protective association does not.

The minimal state is an outgrowth of persons in the dominant protective association extending the protection of the association to outsiders who are not willing to pay for the services of the association themselves.² On the differences between the ultraminimal state (the one dominant protective association) and the minimal state Nozick states that "an ultraminimal state maintains a monopoly over all use of force except that necessary in immediate self-defense, and so excludes private (or agency) retaliation for wrong

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Nozick refers to the one dominant protective association as the "ultraminimal state."

and the exaction of compensation; but it provides protection and enforcement services only to those who purchase its protection and enforcement policies. People who don't buy a protection contract from the monopoly don't get protected. The minimal (night-watchman) state is equivalent to the ultraminimal state conjoined with a (clearly redistributive) Friedmanewque voucher plan, financed from tax revenues."³

Nozick directs much of his attention to how the ultraminimal state "emerges" into the minimal state. The essence of his argument is that the members of the dominant protective association must supply those outside the protective association with protective services. These extra protective services that are provided to the non-members of the protective association are paid for by members of the association placing a tax upon themselves. This act would clearly appear to be redistributive in nature. Nozick, however, argues that this is not necessarily so. Acts of transferring funds, he points out, cannot all be termed "redistributive." He goes on to make the point that the arrangement discussed above where members of the dominant association tax themselves to provide non-members with protective services is not redistributive because of the obligation on their part to do so. "We might elliptically call an arrangement "redistributive" if its

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Ibid:26-27

major (only possible) supporting reasons are themselves redistributive. ("Paternalistic" functions similarly). Finding compelling nonredistributive reasons would cause us to drop this label. Whether we say an institution that takes money from some and gives it to others is redistributive will depend upon why we think it does so. Returning stolen money or compensating for violations of rights are not redistributive reasons."⁴ It is because members of the dominant protective association are obligated to pay for the protective services of non-members that this act cannot be termed redistributive. They are obligated, it is noted, because they violate the rights of non-members and must, therefore, exact compensation. "The dominant protective association with the monopoly element is morally required to compensate for the disadvantages it imposes upon those it prohibits from self-help activities against its clients."⁵ In short, compensation is not redistribution.

Nozick's point is well taken. Nozick, who has noted that the minimal state is a result of an invisible hand process, has adequately dismissed the idea that the minimal state is redistributive in nature. No state, after all, can be the result of an invisible hand process and be redistributive, too. Commonly understood, redistribution

4 Ibid:27

5 Ibid:114

refers to a conscious undertaking to bring about a desired end. Redistribution can only be intended. If it could be said that the minimal state is redistributive, then, it could not be said that it is the result of an invisible hand process. The redistributive nature of it would deny this.

The minimal state may not be redistributive, but this does not necessarily mean that it is a result of the evolutionary process. In fact, it is not. As discussed earlier, for something to be a result of an invisible hand process, it has to be unintended. The end cannot be planned for, nor can it be made. The minimal state, however, is not such an end. It was planned for, and it was deliberately brought about. The minimal state, which is descriptive of a state where protection is offered to all persons whether they pay for the service or not, would have had to have been intended. Members of the dominant protective association (in the ultraminimal state) by taxing themselves to provide protective services to non-members consciously "choose" to move from the ultraminimal state to the minimal state. They planned for it, implemented the plan, and arrived at an end that was intended. Whether their actions are redistributive or compensative is of little matter. What is of concern is whether or not the members know what their actions will produce, and they do. In that this is the case, the minimal state could not

have emerged. Nozick has broadened beyond acceptable limits the definition of an invisible hand process by professing the minimal state to be the result of one.

II

There are some institutions-orders-outcomes the evolutionary process is capable of generating but the minimal state is not one. Proponents of the evolutionary process have always been quick to point to the desirable outcomes that it can bring about. As this essay has hopefully pointed out, this is only part of the picture. Not only do the proponents of the evolutionary process fail to note the undesirable outcomes of it, they fail to note the desirable outcomes that the evolutionary process cannot bring about. Attention has already been given to the undesirable and desirable outcomes of the evolutionary process, it is time now to examine some of the desirable outcomes the evolutionary process cannot generate.

It would seem that the institution of taxation could not have emerged; it could not have been the result of an invisible hand process. Attention will later be directed to the reason why taxation could not have emerged, but first it is important to decide whether it is a desirable outcome.

As has been stated before, whether something is desirable or not depends upon individuals' preferences. Desirability, if it is to have any meaning whatsoever, cannot

be decided outside the realm of individuals' preferences. Buchanan has noted that "a situation is judged 'good' to the extent that it allows individuals to get what they want to get, whatsoever this might be, limited only by the principle of mutual agreement."⁶ The definition of desirable is the same as Buchanan's definition of 'good': a situation is judged 'desirable' to the extent that it allows individuals to get what they want to get, whatsoever this might be, limited only by the principle of mutual agreement.

Taxation may be seen to be desirable in that it provides a means for individuals to obtain many of the goods and services they demand. To some, it would appear nonsensical to call taxation a desirable institution-order-outcome, for, after all, it is at essence, coercive. The coercive nature of it would seem to deny to it the description of desirable. There is a misunderstanding here, however. Notice needs to be taken of the "type" of coercion, for it is only a certain type of coercion that denies that something may be considered desirable.

Coercion may be seen to be of two types: voluntary and involuntary. Voluntary coercion is perhaps a misnomer. Coercion that is voluntary (that is, agreed to) fails to

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James M. Buchanan, The Limits of Liberty: Between Anarchy and Leviathan (Chicago, The University of Chicago Press, 1975):2

to be descriptive of coercion as a state where one is prevented from taking actions outside those prescribed for him by others. This, of course, is descriptive of involuntary coercion. The possible misnomer (voluntary coercion), will, however, be employed in the upcoming discussion because the English language seemingly lacks a word or phrase that means "agreeing to constraints," and it is this that is pertinent to what follows.

Taxation in that it can be said to be coercive contains coercion of the voluntary type. Taxation could not have come about without coercion, and taxation is desired for that which it provides. What it specifically provides is public goods, and there is evidence supportive of the belief that there is a genuine demand on the part of the public for public goods.

In the large numbers setting, each individual would see his contribution to the tax pool as negligible and consequently decide that the benefits of taxation (in the form of public goods) would be his irrespective of whether he paid his taxes or not. In this setting, few persons would pay taxes and the institution of taxation would not exist. The fact that only few persons would pay taxes is not evidence that taxation is not desired; it is simply evidence that there is a different behavioral response with respect to the payment of public goods and private goods.

If it is assumed that the entire population wanted public goods of one type or another, the outcome would still be that few public goods would come about because the means of financing them would not exist. The situation is one where taxation is desired, but would not emerge because of the generalized prisoners' dilemma members of the public find themselves in. If taxation is to exist, it must come about through other means than voluntary ones.

This means must take the form of compulsory taxation. Individuals, desiring taxation, note that it is not likely to exist unless all persons are made to pay their share of the tax bill. In this situation, individuals would agree to the coercion that taxation entails.

Critics of the above analysis may make the point that taxation may not be a desirable outcome because there are individuals that would not want it. The case may be where 51% of the individuals want taxation and 49% do not, either because they feel that they do not want public goods, or feel that the type of public goods they want can be purchased privately, and they prefer this course of action.

If either of these two is the case, and only a simple majority of the public want compulsory taxation, then the argument can quite justifiably be made that it is both inefficient and nonbeneficial to have the institution of taxation. This, then, is an argument against the "principle

of fairness." "This principle holds that when a number of persons engage in a just, mutually advantageous, cooperative venture according to rules and thus restrain their liberty in ways necessary to yield advantages for all, those who have submitted to these restrictions have a right to similar acquiescence on the part of those who have benefited from their submission. Acceptance of benefits (even when this is not giving of express or tacit undertaking to cooperate) is enough, according to this principle, to bind one."⁷

The "principle of fairness," however, does not apply to the discussion of taxation as outlined above, and for this reason, the case against the "principle of fairness", while it is a strong one, is irrelevant. The case against the "principle of fairness" makes the point that some individuals may not want the public service they are provided with, and thus, should not be made to pay for it. As outlined in this chapter, however, everyone wanted public goods that would be paid for through taxation. This was an assumption. And whether it is a reasonable assumption is of little consequence here. The point here is that even if all individuals wanted taxation it would not come about through voluntary means. Nor could it ever be thought of as an "unintended consequence of human action." It is, however, desirable in the sense that everyone wants it.

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Robert Nozick, Anarchy, State and Utopia (New York, Basic Books, Inc., 1974):90

Olson agrees that taxation would not come about through voluntary means. He states that "almost any government is economically beneficial to its citizens, in that the law and order it provides is a prerequisite of all civilized economic activity. But despite the force of patriotism, the appeal of the national ideology, the bond of a common culture, and the indispensability of the system of law and order, no major state in modern history has been able to support itself through voluntary dues or contributions. Philanthropic contributions are not even a significant source of revenue for most countries. Taxes, compulsory payments by definition, are needed."⁸

The fact that the emergent or evolutionary process could not have "produced" the desired institution of taxation (under certain assumptions) seems to be a serious failure of it. Not only does it provide some outcomes that are undesirable, it is unable, at times, to provide some outcomes that are desirable.

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Mancur Olson, The Logic of Collective Action: Public Goods and the Theory of Groups (Cambridge, Mass., Harvard University Press, 1971):13

CHAPTER VIII
THE EVOLUTIONARY PROCESS AND BEYOND

Evolution, unhampered and unconstrained, does not always generate efficient and desirable institutional forms. The evolutionary process is just as likely to lead one to the (inefficient) lower-right hand box in the prisoners' dilemma game as it is to lead one to the (efficient) upper-left hand box. Once this is noted, and accepted, the myth that "emergence means efficiency" is finally ejected from the economists' and social philosophers' list of beliefs. Then, finally, the important work of "improving" institutions-orders-outcomes can commence on a larger scale.

The case against "emergence means efficiency" is strengthened when it is noted that there are, many times, "preconditions" that need to be present before the evolutionary process will generate efficiency. And the "preconditions", it should be particularly noted, are not always, and not likely to be, themselves a result of the evolutionary process.

The Hayek position, which implicitly expressed the idea that the evolutionary process generated efficient outcomes, ultimately depended upon the acceptance of a certain moral code. Specifically, a moral code that called for a strict adherence to abstract, general rules.

The "state of affairs" is different, however. For the most part, individuals do not comply with the discipline of abstract, general rules. There is no "good" or "bad" reason for this; this judgment, however, does not preclude the advancement of an explanation for why it is.

Without proceeding into matters of metaphysics, the "primary" reason individuals have not submitted to general rules for any substantial length of time, is that general rules, which are long-run in nature, are oftentimes a burden to be disposed of by individuals that tend to be short-run in nature.¹ Secondly, once some individuals have decided not to observe general rules, this behavior, then, makes it more costly for others to continue to observe them.

In a society, the benefits for an individual from observing rules largely comes from others observing them as well. As some individuals refuse to observe general

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The fact that individuals do not follow long-run rules is, to a great extent, an indication that they tend to be short-run in nature. Numerous economics examples will attest to this fact. (See Ludwig von Mises, Human Action: A Treatise on Economics, Third Edition; Chicago, Henry Regnery Co., 1966) The perhaps interesting question of why individuals are short-run in nature is beyond both the scope of this discussion and the author. Unrelated to this, but an interesting note, is that the inclination for individuals to be short-run in nature may be largely due, at a primary level, to the fact that many individuals do not see the full price of such behavior. This being true, they would, of course, consume more short-run actions than if this were not true.

rules, other individuals, notably those on the margin, will react to this decision by themselves deciding not to adhere to general rules because the cost of doing so has increased. Of course not all individuals will initially react this way; after all, individuals differ in their preference for general rules, in and of themselves, that is, for their "moral" worth, and for the observable results that general rules are said to "produce" when adhered to by a society. However true this may be, the process started by the first individuals to renounce general rules will start a chain reaction of events. As noted earlier, once some individuals decide not to observe general rules, the benefits for others observing them are decreased and those on the margin will decide it is now too costly to continue to observe them. Consequently, the number of those not observing general rules increases. Once again, as this number increases, a further reduction in benefits of others observing them comes about. In short, the process here generates a "shifting margin." As more individuals become non-observers more will want to, since more will come to be on the margin.

It is to be particularly noted that it is a rational action for one to decide not to adhere to general rules. To deny this is to deny that individuals will seek to maximize utility in the face of changing costs and benefits--no longer, then, would it be accurate to speak of "economic"

man. To ask why general rules are not observed is tantamount, then, to asking why utility maximization is. It is in this light that inefficient and undesirable outcomes can be seen to be an outcome of utility maximization.

This fact brings forth the gravity of the situation at hand. Outside a direct change in the preferences of individuals, utility maximization will continue to "generate" outcomes that individuals will label as inefficient and undesirable.

There is one other possible means man has at his disposal. If utility maximization is, at base, the reason for the dilemma man finds himself in, it would seem reasonable that a rejection of it by individuals might offer a prospect for improvement.² At present, however, individuals do not appear to be moving away from maximizing utility, nor do they appear to be changing their preferences in a way that guarantees that the social evolutionary process would "produce" efficient and desirable institutional forms. This would seem, then, to add support to the view that the way to "improvement" is, more realistically and practically, achieved by "changing" institutions, not individuals. And a principle theme of this essay has been that improvement is needed.

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That is, individuals must decide not to maximize utility. This is, of course, a specific form that a "preference change" might take on and thus is a special case of the more general case.

Evolution, simply and properly defined, would seem to present one with numerous examples of inefficient and undesirable outcomes. In the face of this evidence, it is unlikely the "best" institutions-orders-outcomes have yet been achieved. It would appear, then, that the evolutionary process could be improved upon, and in this modern setting, failing to realize this is not done without cost.

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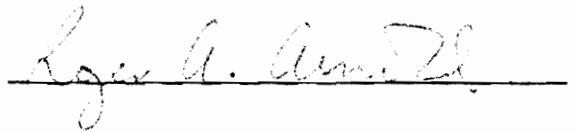
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A handwritten signature in cursive script, reading "Roger A. Arnold", is written over a solid horizontal line.

THE EFFICIENCY PROPERTIES OF INSTITUTIONAL EVOLUTION:
WITH PARTICULAR REFERENCE TO THE
SOCIAL-PHILOSOPHICAL WORKS OF F. A. HAYEK

by

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(ABSTRACT)

In an overall sense, the purpose of this study is to examine closely the evolutionary process with respect to institutional evolution. The position which holds that the evolutionary process generates efficient institutional forms is seen to be dependent upon a certain set of conditions being met. In the more general case, however, the evolutionary process oftentimes generates outcomes that are unintended, inefficient, and undesirable; consequently placing man in what has been referred to as a "social dilemma." At base, this outcome is a result of simple utility maximization on the part of individuals. Policy prescriptions and attitudes towards policy are likely to change once this is noted and understood.