
THE FORTUNES OF LIBERALISM



F. A. HAYEK

THE COLLECTED WORKS OF

F. A. Hayek

THE FORTUNES OF LIBERALISM

Essays on Austrian Economics and the
Ideal of Freedom

F. A. HAYEK

Edited by Peter G. Klein



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EDITORIAL FOREWORD

I

The Collected Works of F. A. Hayek is the product not of the design but of the perception of W. W. Bartley III that the great importance of Hayek's thought would not be fully grasped without a complete, newly ordered, and annotated presentation of his writings. Thus the series is an unplanned outcome of Hayek's offer to place at Bartley's disposal all of his papers, should he undertake Hayek's biography, which Bartley did agree to do. In the course of their many talks—about Popper, about Wittgenstein, about Vienna—Hayek realised that Bartley had acquired a unique understanding of the Vienna of Hayek's birth and youth. Bartley, for his part, as he examined the depth and range of Hayek's writings, came to realise that the knowledge of Hayek's ideas held by contemporary thinkers was at best fragmentary and at worst woefully non-existent. Just as Ludwig Wittgenstein's English followers knew little of his Austrian life until Bartley wrote of it, Hayek's English and American readers knew little of Hayek's early work written in German. Even most economists had ceased to read Hayek's work on economic theory, and neglected entirely Hayek's ideas about theories of perception and the growth of knowledge. Yet none of Hayek's writing is entirely unconnected to the whole, and now, placed within its historical, theoretical, and critical context, which is the rewarding labour of the editors, Hayek's collected writing provides an invaluable education in a subject which is nothing less than the development of the modern world.

This new collection of essays, *The Fortunes of Liberalism: Essays on Austrian Economics and the Ideal of Freedom*, is the fourth volume of the Collected Works of F. A. Hayek and the third volume in order of appearance. Of particular interest is the essay "The Economics of the 1920s as Seen from Vienna", which is published here for the first time, and the essay "The Rediscovery of Freedom: Personal

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Recollections", which is published for the first time in English. Also published for the first time is the Addendum to chapter 1, and for the first time in English chapters 3 and 7 and sections of chapters 4 and 6. With but two exceptions the remaining chapters have not been readily accessible and are here collected for the first time.

II

Much has changed in the world since the inception of this series. The fall of the Berlin wall is the dramatic and symbolic event that had long been prefigured in the criticisms of socialism made by Hayek, Mises, and their followers. Now irrefutable, Hayek's arguments may come to be read as a touchstone in a renewed examination of the evolution of the extended order of society. For the Hayek specialist who is encouraged to discover how Hayek's ideas have evolved in terms of his unfailing sense of what is the key problem to be solved, the essays in this volume about Hayek's teachers and colleagues will be of considerable interest. One may well be startled to see in chapter 3 a young Hayek in 1926 writing of "the most important economic problem, the laws of income distribution". Even then there were hints that these 'laws' would be merely foothills beyond which a high range of unexplored difficulty could be glimpsed. So Friedrich von Wieser, Hayek's teacher, writes of himself, "Henceforth it became my dream to write anonymous history. This too, however, came to nothing. The most obvious social relationship manifests itself in the economy—that had to be clarified first, before one could even consider fathoming more deeply concealed relations".

The question of the place of history in social evolution and the role historians play in our national identities connect all of the essays in this volume. Like an *ostinato* figure, the theme is sounded at the very start in Menger's epochal controversy with the German historical school, the *Methodenstreit*, over whether it is possible to discover laws of history that explain or predict or determine the destiny of nations. The great tragedy of the twentieth century was the twin monstrosities, the social calamities of Nazi Germany and Soviet Communism, which proved that if history is not "bunk", to use Henry Ford's famous monosyllable, *historicism* is not only wrong, but dangerously wrong. In the end it is clear the fortunes of liberalism rest on the objectivity of the historians—among whom Hayek enlists all students of social phenomena—"of the possibility of a history which is not written in the service of a particular interest".

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How to reconcile the “supremacy of truth” that Hayek holds as the standard for all historians with the obscurity of events that economists must discern is the task that emerges from these pages. But then, as Hayek reminds us in the essay on Röpke, “an economist who is nothing but an economist cannot be a good economist”.

III

This volume was assembled under painful circumstances. The founding editor of the Collected Works of F. A. Hayek, W. W. Bartley III died of cancer in February 1990. Nothing can prepare one for such a loss. But we were prepared to do the work that will remain as a testament to his foresight, perseverance, and intelligence. Of those who have kept the project together and moving forward during this difficult year, I am most grateful to Mr. Walter Morris of the Vera and Walter Morris Foundation. His has been, as Bartley wrote, the presiding genius behind the larger project, without whose advice and support it never could have been organized or launched and, I will now add, without whose unflagging counsel and sympathy the project would not have continued.

A similar debt of gratitude must also go to Mr. John Blundell of the Institute for Humane Studies. I should also like to express my thanks to Ms. Penelope Kaiserlian of the University of Chicago Press and to Mr. Peter Sowden of Routledge, not only for their renewed commitment to the series but for their patience and acceptance of the complexity of this undertaking; which complexity would not be resolved nor books produced without the knowledge and determination of the Assistant Editor, Ms. Gene Opton. We are also fortunate to have the translations of Dr. Grete Heinz. Thanks are due to Ms. Charlotte Cubitt, Ms. Leslie Graves, and Mr. Eric O’Keefe; and especially to Peter Klein for being curious and energetic enough to complete with great distinction the very painstaking work of editing this volume, and for being modest enough not to expect that virtue has any other reward.

Finally, the project could not have been carried through successfully without the generous financial assistance of the supporting organisations, whose names are listed prominently at the beginning of the volume and to which all associated with the volume are grateful. The support of these sponsors—institutions and foundations from six continents—not only acknowledges the international appre-

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ciation of Hayek's work, but also provides very tangible evidence of the extended order of human cooperation of which Hayek writes.

Stephen Kresge
Oakland, California
February 1991

INTRODUCTION

“Can capitalism survive?” asked Joseph Schumpeter in 1942. “No. I do not think it can”.¹ But capitalism survived: Now half a century later we find socialism facing self-destruction, the ideal of central planning collapsing with the failed economies of East and Central Europe. If there is any lesson to be learned from the events of 1989, it is this: The rebirth of liberalism in that part of the world is largely, if not completely, a rebirth of capitalism—a recognition that only the market order can provide the level of well-being that modern civilisation requires. Though not yet fully understood, this is now widely recognised. Robert Heilbroner, certainly no friend of capitalism, writes that recent history “has forced us to rethink the meaning of socialism. As a semi-religious vision of a transformed humanity, it has been dealt devastating blows in the twentieth century. As a blueprint for a rationally planned society, it is in tatters”.²

For F. A. Hayek this is but a mild surprise. As an ‘Austrian’ economist Hayek has always had an understanding of the market somewhat different from that of his contemporaries, not only those who oppose capitalism, but many of those who defend it as well. Throughout most of this century ‘the economic problem’ has been seen as the *allocation of resources*, the problem of finding a distribution of productive resources to supply a set of competing and potentially unlimited demands—for which a solution can in principle be computed by an outside observer (and, by implication, a central planner). For Hayek and the Austrians, by contrast, economics is about the *coordination of plans*, the means by which a ‘highly complex

¹Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper & Brothers, 1942; third edition, 1950), p. 61.

²“Reflections After Communism”, *The New Yorker*, September 10, 1990, pp. 91–100, esp. p. 98. An expanded version appears as “Analysis and Vision in Modern Economic Thought”, in the *Journal of Economic Literature*, vol. 28, September 1990, pp. 1097–1114.

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order' of human cooperation emerges from the plans and decisions of isolated individuals, operating in a world of tacit and dispersed knowledge. Explaining the regularity of phenomena like prices and production, money, interest, and business fluctuations, and even law and language, when these phenomena are part of no one's deliberate intention, is the task of economic science. Only by viewing the social order from this perspective can we hope to know why markets *work*, and why efforts to construct societies without markets are bound to fail.

Hayek belongs to the fourth generation of the Austrian school of economists, the generation of the diaspora that flowed out of Vienna to places like London and Chicago, Princeton, and Cambridge, Mass., so that the adjective 'Austrian' is now of purely historical significance. Throughout his migrations to England and the United States, though, Hayek has retained much of the perspective of the school founded by Carl Menger. Since its beginnings, the Austrian school has been known for its distinct and original understanding of the economic order, some parts of which have (to an extent) been incorporated into the mainstream of economic thought while others were tossed aside and forgotten. Among the former we may include the once-revolutionary theory of value and exchange offered in Menger's *Grundsätze der Volkswirtschaftslehre*, whose 1871 publication marked the beginnings of the school; among the latter is the attack on the feasibility of economic calculation under socialism developed by Hayek's senior colleague and mentor Ludwig von Mises in the 1920s, a theory which formed the basis for the modern Austrian understanding of the market as a *process* of learning and discovery, rather than an equilibrium state of affairs. Conventional neoclassical economics, believing Mises to have been refuted long ago by the Lange and Taylor models of 'market socialism', has had virtually nothing to say on the viability of central planning. Not so for the Austrians. Hayek's conception of what the market *is*, and how the market process works, has led him to the conclusion that socialism is a grave mistake—if you will, a 'fatal conceit'. And it is upon this understanding that he builds his defence of the liberal order.

This is the spirit in which the present volume is offered. In these essays Hayek writes on Austrian economics, the starting point for his own intellectual odyssey, and on the fortunes of liberalism, the social philosophy of the market order with which his work is so closely associated. The first part contains essays and lectures on the major figures of the Austrian school: Carl Menger, Hayek's teacher Friedrich von Wieser, Ludwig von Mises, and Joseph Schumpeter (Austrian by training and one of the dominant personalities in twentieth-

INTRODUCTION

century economic thought, though not a member of the Austrian school *per se*); the lesser-known economists Ewald Schams and Richard von Strigl; and two related figures on the Viennese intellectual scene, the philosophers Ernst Mach and Ludwig Wittgenstein, Hayek's second cousin. The second Part collects writings on the rediscovery of freedom in post-war Europe, with special reference to Germany and the international Mont Pèlerin Society, an influential organisation of liberals founded by Hayek in 1947. Both Parts touch on a theme that pervades all Hayek's work on the social order: the role of ideas—economic theory in particular—in the preservation of liberal society.

The remainder of this Introduction will sketch Hayek's career and try to place parts of his thought in historical and theoretical perspective. Before we continue, however, one terminological note is in order. Hayek uses the word 'liberalism' in its classical, European meaning, as the social order based on free markets, limited government under the rule of law, and the primacy of individual freedom. As he explains in the Foreword to the first (1956) paperback edition of his classic *The Road to Serfdom*,

I use throughout the term 'liberal' in the original, nineteenth-century sense in which it is still current in Britain. In current American usage it often means very much the opposite of this. It has been part of the camouflage of leftish movements in this country, helped by the muddleheadedness of many who really believe in liberty, that 'liberal' has come to mean the advocacy of almost every kind of government control. I am still puzzled why those in the United States who truly believe in liberty should not only have allowed the Left to appropriate this almost indispensable term but should even have assisted by beginning to use it themselves as a term of opprobrium.³

We shall abide here by these strictures and continue to favour 'liberal' over the less elegant 'classical liberal' or 'libertarian', now becoming standard parlance in the United States.

Hayek came to the University of Vienna at age nineteen just after the First World War, when it was one of the three best places in the world to study economics (the others being Stockholm and Cambridge, England). Though he was enrolled as a law student, his

³F. A. Hayek, *The Road to Serfdom* (London: Routledge & Kegan Paul; Chicago: University of Chicago Press, 1944; reprinted, 1976), p. ix.

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primary interests were economics and psychology, the latter due to the influence of Mach's theory of perception on Wieser and Wieser's colleague Othmar Spann, and the former stemming from the reformist ideal of Fabian socialism so typical of Hayek's generation. Like many students of economics then and since, Hayek chose that subject not for its own sake, but because he wanted to make the world a better place—the poverty of post-war Vienna serving as a daily reminder of such a need. Socialism seemed to provide a solution; then in 1922, Mises, who was not on the paid Vienna faculty but was a central figure in the economics community there, published his *Die Gemeinwirtschaft*, later translated as *Socialism*. "To none of us young men who read the book when it appeared", Hayek recalls, "the world was ever the same again" (this volume, p. 133). *Socialism*, an elaboration of Mises's pioneering article from two years before, argued that economic calculation *requires* a market for the means of production; without such a market there is no way to establish the values of those means and, consequently, no way to determine their proper uses in production. From Mises, who was briefly Hayek's superior in a temporary government office and in whose private seminar Hayek became a regular participant, Hayek was gradually convinced of the superiority of the market order.

Mises had done earlier work on monetary and banking theory, successfully applying the Austrian marginal utility principle to the value of money and then sketching a theory of industrial fluctuations based on the doctrines of the English currency school and the ideas of the Swedish economist Knut Wicksell. Hayek used this last as a starting point for his own research on fluctuations, explaining the business cycle in terms of credit expansion by banks. His work in this area earned him an invitation to lecture at the London School of Economics and Political Science and then to occupy its Tooke Chair in Economics and Statistics, which he accepted in 1931. There he found himself among a vibrant and exciting group: Lionel (later Lord) Robbins, Arnold Plant, T. E. Gregory, Dennis Robertson, John Hicks, and the young Abba Lerner, to name just a few. Hayek brought his (to them) unfamiliar views,⁴ and gradually the 'Austrian' theory of the business cycle became known and accepted.

⁴Hicks notes, in reference to Hayek's first (1931) English book, that "*Prices and Production* was in English, but it was not English economics". Sir John Hicks, "The Hayek Story", in his *Critical Essays in Monetary Theory* (Oxford: Clarendon Press, 1967), p. 204.

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Within a very few years, however, the fortunes of the Austrian school would suffer a dramatic reversal. First, the Austrian theory of capital, an integral part of the business-cycle theory, came under attack from the Italian-born Cambridge economist Piero Sraffa and the American Frank Knight, while the cycle theory itself was forgotten amid the enthusiasm for the *General Theory* of John Maynard Keynes. Second, beginning with Hayek's move to London and continuing until the early 1940s, the Austrian economists left Vienna, for personal and then for political reasons, so that a school ceased to exist there as such. Mises left Vienna in 1943 for Geneva and then New York, where he continued to work in isolation; Hayek remained at the LSE until 1950, when he joined the Committee on Social Thought at the University of Chicago. Other Austrians of Hayek's generation would become prominent in the United States—Gottfried Haberler at Harvard, Fritz Machlup and Oskar Morgenstern at Princeton, Paul Rosenstein-Rodan at the Massachusetts Institute of Technology—but their work no longer seemed to show any traces of the Menger tradition.

At Chicago Hayek once again found himself among a dazzling group: The economics department, led by Knight, Jacob Viner, Milton Friedman, and later George Stigler, was one of the best anywhere; Aaron Director at the law school would soon set up the first law and economics program; and internationally known scholars like Hannah Arendt and Bruno Bettelheim were active lecturers. But economic theory, in particular its *style* of reasoning, was rapidly changing: Paul Samuelson's *Foundations* had appeared in 1949, establishing physics as the science for economics to imitate, and Friedman's 1953 essay on 'positive economics' set a new standard for economic method. In addition Hayek had ceased to work on economic theory, concentrating on psychology, philosophy, and politics, and Austrian economics entered a prolonged eclipse. Some important work in the Austrian tradition was done during this period by two younger men who had studied with Mises at New York University: Murray Rothbard, who published his *Man, Economy, and State* in 1962, and Israel Kirzner, whose *Competition and Entrepreneurship* appeared in 1973. But for the most part the Austrian tradition lay dormant.

Then in 1974 something quite startling occurred: Hayek received a Nobel prize in economics. Due to the prestige of this award, interest in the Austrian school was revived; coincidentally, a number of isolated scholars working in the Austrian tradition had been brought together that same year at a memorable conference in

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South Royalton, Vermont.⁵ Since then an 'Austrian revival' has continued to spread, with books, journals, and even graduate programs specialising in the Menger tradition appearing at a growing rate. And Austrian economics is slowly beginning to be noticed by the rest of the profession. Some areas in which modern Austrian views are starting to exert influence include banking theory, advertising and its relation to market structure, and the reinterpretation of the socialist calculation debate;⁶ furthermore, the literature of the last fifteen years or so on the economics of incomplete information and the theory of incentives may be considered an outgrowth of Hayek's work on dispersed knowledge and prices as signals, though such a debt is often forgotten.⁷

There is another reason for contemporary economists to be interested in Hayek. Today the analysis of the welfare properties of the market is framed as a two-sided debate: The defenders of free markets are the 'new classical' economists, whose theories depend on the assumptions of hyper-rational human agents with 'rational expectations' and instantaneous market clearing; the skeptics, usually carrying some sort of 'Keynesian' label, view expectations as more problematic and prices as slow to adjust. Hayek, in stark contrast, bases a defence of the market not on human rationality, but on human ignorance! "[T]he whole argument for freedom, or the greater part of the argument for freedom, rests on the fact of our

⁵The proceedings of that conference were published as *The Foundations of Modern Austrian Economics*, ed. Edwin G. Dolan (Kansas City: Sheed & Ward, 1976). A follow-up volume appeared two years later: *New Directions in Austrian Economics*, ed. Louis M. Spadaro (Kansas City: Sheed Andrews & McMeel, 1978).

⁶For example, Lawrence H. White, *Free Banking in Britain: Theory, Experience, and Debate, 1800-1845* (Cambridge: Cambridge University Press, 1984), and George A. Selgin, *The Theory of Free Banking: Money Supply Under Competitive Note Issue* (Totowa, N.J.: Rowman & Littlefield, 1988); Robert B. Ekelund, Jr., and David S. Saurman, *Advertising and the Market Process* (San Francisco: Pacific Institute for Public Policy Research, 1988); and Don Lavoie, *Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered* (Cambridge: Cambridge University Press, 1985).

⁷See, for example, the excerpt from the *New Palgrave* dictionary published as *Allocation, Information and Markets* (London: Macmillan, 1989). It is also curious that the emerging literature on 'coordination failures' in macroeconomics, pioneered by the theorists Peter Diamond and Martin Weitzman, makes no reference to Hayek, though the problem of coordination is an explicit theme in his writings (hence Gerald P. O'Driscoll's study *Economics as a Coordination Problem: The Contributions of Friedrich A. Hayek* (Kansas City: Sheed Andrews & McMeel, 1977)). For a summary of this literature see Russell Cooper and Andrew John, "Coordinating Coordination Failures in Keynesian Models", *Quarterly Journal of Economics*, vol. 103, August 1989, pp. 441-463.

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ignorance and not on the fact of our knowledge.”⁸ Hayek’s agents are *rule followers*, responding to price signals within a system selected by a process of evolution—a spontaneous order, rather than a system deliberately chosen; yet their actions bring unintended benefits for the system as a whole, benefits that *could not* have been rationally predicted. This is quite strange to the modern economist, for whom evolution and spontaneity play little if any role.⁹

Hayek’s work is also different from the new classical economists’ in another regard: It is broader, integrating economic theory into a wide social philosophy, encompassing political, legal, and moral aspects of the social order. The new classicals, instead, are purely theorists and have not attracted a broadly based following. Leonard Rapping, himself one of the first ‘rational expectations’ economists, notes that “[m]any of the young and idealistic are attracted by the concepts of freedom and justice, not efficiency and abundance. Aside from their contributions to economic theory, Friedman and Hayek wrote powerful defences of capitalism as a system that promotes liberal democracy and individual freedom. This attracted to their ideas many adherents outside of economics. The new classicals have no such agenda.”¹⁰ Indeed, the students of Austrian economics often have a wide range of interests, and the interdisciplinary flavour of the Austrian tradition surely helps explain its appeal.

Clearly the Austrian revival owes as much to Hayek as to anyone. But are Hayek’s writings really ‘Austrian economics’—part of a

⁸From Hayek’s remarks at a conference organised by the Congress for Cultural Freedom and published as *Science and Freedom* (London: Martin Secker & Warburg, 1955), p. 53.

⁹The interpretation of economic behaviour as ‘routines’ or rules of thumb, developed by Richard Nelson and Sydney Winter in their *Evolutionary Theory of Economic Change* (Cambridge, Mass.: Harvard University Press, 1982), bears some relation to Hayek’s idea of rule-following agents. It is also true that the equilibrium concepts of modern game theory partly reflect the notion of ‘plan coordination’ mentioned before, in the sense of finding sets of mutually consistent ‘strategies’, and that the theory of repeated games yields significant insights into the evolution of cooperative behaviour. Game theory, however, does not explain how cooperative action comes to be selected; it shows only that strategies of repeated cooperation can be mutual best responses. A standard reference on such matters is Robert Axelrod, *The Evolution of Cooperation* (New York: Basic Books, 1984). For an application with an Austrian flavour, see Bruce L. Benson, *The Enterprise of Law: Justice Without the State* (San Francisco: Pacific Institute for Public Policy Research, 1990).

¹⁰In a review of Kevin D. Hoover, *The New Classical Macroeconomics: A Skeptical Inquiry* (New York and Oxford: Basil Blackwell, 1988), in the *Journal of Economic Literature*, vol. 28, March 1990, pp. 71–73, esp. p. 73.

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separate, recognisable tradition—or should we regard them, instead, as an original, deeply personal contribution?¹¹ Some observers charge that Hayek's later work, particularly after he began to turn away from technical economics, shows more influence of his friend Sir Karl Popper than of Menger or Mises: One critic speaks of "Hayek I" and "Hayek II", while another writes on "Hayek's Transformation".¹²

Though this is to some extent merely a matter of labels, there are some substantive issues involved. One is whether or not it is useful to distinguish between schools of thought within a discipline at all. Hayek himself is of two minds on this. In the first chapter of this volume, written in 1968 for the *International Encyclopaedia of the Social Sciences*, he describes his own generation of the Austrian school with the following:

But if this fourth generation in style of thinking and in interests still shows the Vienna tradition clearly, nonetheless it can hardly any longer be seen as a separate school in the sense of representing particular doctrines. A school has its greatest success when it ceases as such to exist because its leading ideals have become a part of the general dominant teaching. The Vienna school has to a great extent come to enjoy such a success. (This volume, p. 52)¹³

¹¹Wieser's have generally been considered a personal contribution, by Hayek himself and others. For a contrary view, see Robert B. Ekelund, Jr., "Wieser's *Social Economics*: A Link to Modern Austrian Theory?", *Austrian Economics Newsletter*, vol. 6, Fall 1986, pp. 1–2, 4, 9–11.

¹²For Hayeks I and II see T. W. Hutchinson, "Austrians on Philosophy and Method (since Menger)", in his *The Politics and Philosophy of Economics: Marxians, Keynesians, and Austrians* (New York and London: New York University Press, 1984), pp. 203–232, esp. pp. 210–219; for the 'transformation' see Bruce J. Caldwell, "Hayek's Transformation", *History of Political Economy*, vol. 20, no. 4, 1988, pp. 513–541.

¹³It is significant that those neoclassical economists who see any truth in the Austrians' writings tend to argue similarly that the latter are merely saying the same things as everyone else but in a different language (i.e., Austrians generally reason verbally rather than mathematically). Mises himself once said nearly this, in the following remarkable statement: "We usually speak of the Austrian and the Anglo-American schools [following William Stanley Jevons] and the school of Lausanne [following Léon Walras]. . . [yet in fact] these three schools of thought differ only in their mode of expressing the same fundamental idea and . . . are divided more by their terminology and by peculiarities of presentation than by the substance of their teachings." Mises, *Epistemological Problems of Economics* (New York and London: New York University Press, 1981; first published 1933), p. 214. Mises would later abandon this view, as have recent scholars of the Menger-Jevons-Walras 'marginalist revolution'. On this see the references in this volume, chapters 1 and 2.