
THE TREND OF
ECONOMIC THINKING



F. A. HAYEK

THE COLLECTED WORKS OF

F. A. Hayek

THE TREND OF
ECONOMIC THINKING

Essays on Political Economists and
Economic History

F. A. HAYEK

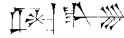
Edited by W. W. Bartley III and Stephen Kresge



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EDITORIAL FOREWORD

I

The Trend of Economic Thinking, a new collection of essays by Hayek concerning political economists and economic history, is the third volume of The Collected Works of F. A. Hayek, a new standard edition of his writings, and the second volume in order of appearance. The first volume, *The Fatal Conceit*, was published in Britain in 1988 and in the United States in 1988.

Of the work's fifteen chapters, five have never previously been published, and another two have never before been published in English. Most of the remaining chapters are difficult to obtain, only three of them being readily available in other Hayek collections. These three essays are placed here as part of the more systematic presentation aimed for in the Collected Works.

II

The Collected Works of F. A. Hayek attempts to make virtually the entire Hayek corpus available to the reader for the first time. The chief organisation is thematic, but within this structure a chronological order is followed where possible.

The series opens with two closely-related books on the limits of reason and planning in the social sciences—*The Fatal Conceit*, a new work, and *The Uses and Abuses of Reasons: The Counter-Revolution of Science and Other Essays*, a work never previously published in Britain. The series continues with two collections of historical and biographical essays (*The Trend of Economic Thinking: Essays on Political Economists and Economic History* and *The Fortunes of Liberalism and the Austrian School*).

The bulk of Hayek's contributions to economics are contained in the four volumes *Nations and Gold*; *Money and Nations*; *Investigations in Economics*; and *Monetary Theory and Industrial Fluctuations*.

These volumes are followed by two volumes of documentation, historical record, and debate: *Contra Keynes and Cambridge* and *Socialism and War*. The texts will be published in corrected, revised

EDITORIAL FOREWORD

and annotated form, with introductions by distinguished scholars intended to place them in their historical and theoretical context.

It is the intention of the editors that the series of volumes be complete in so far as that is reasonable and responsible. Thus essays which exist in slightly variant forms, or in several different languages, will be published always in English or in English translation, and only in their most complete and finished form unless some variation, or the timing thereof, is of theoretical or historical significance. Some items of ephemeral value, such as short newspaper articles and book notices of a few lines written when Hayek was editing *Economica*, will be omitted. And of course the correspondence to be published will be mainly that which bears significantly on Hayek's literary and theoretical work in economics, psychology, biography and history, political theory, and philosophy.

III

The preparation of a standard edition of this type is a large and also expensive undertaking. First and foremost amongst those to be thanked for their very great assistance are W. Glenn Campbell, Director Emeritus of the Hoover Institution on War, Revolution and Peace, Stanford University, and John Raisian, Acting Director of the Hoover Institution, for the generous decision to provide the principal underlying support for this project. The presiding genius behind the larger project, without whose advice and support it never could have been organised or launched, is Walter S. Morris, of the Vera and Walter Morris Foundation. Another institution whose directors watched carefully over the inception of the project, and whose advice has been invaluable, is the Institute for Humane Studies, George Mason University. The editor is particularly indebted to Leonard P. Liggio, Walter Grinder, and John Blundell, of the Institute for Humane Studies. Equally important has been the unflagging support and advice of Norman Franklin, former Head of Routledge & Kegan Paul, who had been Hayek's publisher for many years. I should also like to express my deep thanks to Mrs. Penelope Kaiserlian, Associate Director of the University of Chicago Press, and to Mr. Peter Sowden, of Routledge. 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 deeply grateful. The support of these sponsors—institutions and foundations from six continents—

EDITORIAL FOREWORD

not only acknowledges the international appreciation of Hayek's work, but also provides very tangible evidence of the 'extended order of human cooperation' of which Hayek writes.

W. W. Bartley, III

F.A. HAYEK

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THINKING

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INTRODUCTION

Friedrich August von Hayek was born in 1899 in what was then Vienna. The name is still in use, unlike, say, Saigon; and, unlike, say, Angkor Wat, there is still an inhabited city in the same location; but the Vienna into which Hayek was born, the city which that name conjures up in our memory and imagination, survives no more than the fabled Trebizond. Hayek has lived most of his life, as have many civilised people of the twentieth century, in a kind of exile. England is his adopted country, but he made his last home in Freiburg.

“What a small group!” Hayek has recalled, of his family and friends in that long-lost Vienna. “[Konrad] Lorenz I first encountered when he was a boy of four or five; [Otto] Frisch, the youngest brother of friends of my father; [Ludwig] Wittgenstein, a second cousin of my mother whom I first remember in 1918 when we were both ensigns in the artillery of the Austro-Hungarian army; Böhm-Bawerk, my maternal grandfather’s colleague and mountaineering companion; [Erwin] Schrödinger, the son of my father’s botanical colleague who occasionally accompanied his father to the botanists’ teas at our house. . . .”

What made Vienna the distinctive city that it was, as much as any other the fount of Western culture, is a question to be kept in mind, but it is not the subject here under discussion. What we might observe is that a milieu such as that in which Hayek spent his childhood and youth, a society in which family and associates, position and accomplishment, knowledge and history were so tightly intertwined, meant that the members of such a society were quickly and always apprised of what *mattered*. This is no small feat, as any teacher of the present generation of youth knows too well. It is the *significance* of knowledge and information that leads to the evolution of understanding. Indifference cannot produce the sort of inquiry, the criticism and dissent that is necessary for the growth of knowledge.

What has given Hayek’s writing its enduring value is this sense of what matters. Economists cannot point to a sterling record of prescience. Classical theory foundered on the rocks of a world

depression; Keynesian economics on the phenomenon inelegantly referred to as 'stagflation'; and as for Marxism, the year of 1989 has finally brought the collapse of a system that extracted inhuman costs to enforce a fanatical blunder. For Hayek, it is no consolation to have been right all along. It is in his criticisms of socialism, of the attempt to control by fiat the relations among human beings, that Hayek has demonstrated his keen sense of significance, of the compelling need to define the *problem* faced. Only if a problem has been clearly defined can we know if we have found an answer. This is by no means the simple practice the statement suggests. In wanting the world to conform to our expectations, we too often craft a problem to accept the solution we want, rather than face an unacceptable truth. In his preface to *Conjectures and Refutations*,¹ the work which Sir Karl Popper dedicated to Hayek, Popper observes that his book is largely a variation on one very simple theme—the thesis that we can learn from our mistakes. But then, how do we know when we are mistaken, and when can we afford to admit a mistake? The growth of knowledge is forced through a painful need generated by error, and the lessons of economics can be swift and unsparing. Even so, why should we bother with history, particularly with the history of theories, which is what many of the essays collected in this volume are about? There are several aspects to an answer to this question.

In the chapter "History and Politics", Hayek observes that historical myths have perhaps played nearly as great a role in shaping opinion as historical facts; and that even new ideas reach wider circles usually not in their abstract form but as the interpretations of particular events. Is it then not as important to know the lineage of an idea as the idea itself; to be able to assess its staying power and to observe whether the problem addressed has become a problem solved?

Herewith, then, to compare, a passage from David Hume and one from Richard Cantillon:

Accordingly we find that, in every kingdom into which money begins to flow in greater abundance than formerly, everything takes a new face: labour and industry gain life; the merchant becomes more enterprising, the manufacturer more diligent and skilful, and even the farmer follows his plough with greater alacrity and attention. . . . From the whole of this reasoning we may conclude,

¹ K. R. Popper, *Conjectures and Refutations* (New York and London: Basic Books, 1962).

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that it is of no manner of consequence, with regard to the domestic happiness of a state, whether money be in a greater or less quantity. The good policy of the magistrate consists only in keeping it, if possible, still increasing; because, by that means, he keeps alive a spirit of industry in the nation, and increases the stock of labour, in which consists all real power and riches.²

But Cantillon, foreseeing a less happy outcome, provides an antidote; and completes the economist's 'dismal task':

When a State has arrived at the highest point of wealth (I assume always that the comparative wealth of States consists principally in the respective quantities of money which they possess) it will inevitably fall into poverty by the ordinary course of things. The too great abundance of money, which so long as it lasts forms the power of States, throws them back imperceptibly but naturally into poverty. Thus it would seem that when a State expands by trade and the abundance of money raises the price of Land and Labour, the Prince or the Legislator ought to withdraw money from circulation, keep it for emergencies, and try to retard its circulation by every means except compulsion and bad faith, so as to forestall the too great dearness of its articles and prevent the drawbacks of luxury.³

There is hardly a country in the world today where these two positions are not—still!—under interminable debate. The terms in which the debates are conducted do change, as politics and economic theory continue their three-legged race to define terms of success and escape the rude revelation of a problem for which no solution ever seems forthcoming. The problem is the determination of monetary standards; the rise and fall of prices must be conveyed by some instrument, something with more staying power than, say, a tuning fork. There is a difference between money and a monetary standard; and the dawn of the history of the problem is to be found in Hayek's chapter on the genesis of the gold standard. But it is also in the essay on Dr. Bernard Mandeville where Hayek finds "the definite breakthrough in modern thought of the twin ideas of evolution and of the spontaneous formation of an order", an order which is the result of human action, but not of human design.

² David Hume, *Essays Moral, Political, and Literary*, ed. Eugene F. Miller (Indianapolis, Ind.: LibertyClassics, 1985), pp. 286-288.

³ Richard Cantillon, *Essai sur la Nature du Commerce en Général*, ed. Henry Higgs (London: Frank Cass, 1959), p. 185.

England did not establish the gold standard by any conscious and deliberate act. In fact, it came about as the unintended consequence of the attempt to secure a silver standard through the recoinage of 1695, which was a deliberate, and rather costly, act, the result of an argument by John Locke that a monetary standard was a matter of principle, and that a standard once established in which contracts are made should be upheld. The establishment of Locke's principle did not secure its objective—a silver standard for the shilling, which Sir Isaac Newton, too, tried to secure in his role as Master of the Mint—but it did have the fortuitous outcome of securing for London the leading role in the world's financial markets, since it led much of the world to believe that if they lent their money to London they could be reasonably assured of getting it back. The principle was invoked in 1844 when England returned to the gold standard after the Napoleonic wars, and again in 1926 with not so favourable an outcome. Alas, the principle, like all such, contained premisses the implications of which were not, perhaps still are not, known. Since the shilling—or any denomination of any currency—must be a fixed number, to fix that number relative to any other convertible value is a mysterious achievement for which there is no reliable recipe. Yet a principle, once accepted, takes on the same objective reality as any other event, thus muddying the ancient distinction between 'natural' and 'artificial' laws, the dichotomy which Hayek has found so poisonous in the Aristotelian menu.

The lessons of history are not, or not only, to avoid repeating the mistakes of the past. Whatever history has left to teach—and that value cannot be over-estimated—derives largely from what was not, perhaps could not have been, understood in the first place. Since we cannot predict all of the consequences of any act, or all of the implications of any theory, and do not, therefore, *know* what we are doing, we do not know what we have done.⁴

Consider the difficulties faced by economic forecasters extrapolating economic trends from estimates of present activity which are derived from statistics which in turn undergo endless revisions. In the words of one, "In theory, you're trying to find out what the future is going to be like. That's difficult when the past keeps changing."⁵ The assumption that *economists* can find predictable solu-

⁴ For a full discussion of this thesis and its implications for economic theory, see W. W. Bartley, III, *Unfathomed Knowledge, Unmeasured Wealth* (La Salle, Ill., and London: Open Court, 1990).

⁵ Martin Zimmerman, chief economist at Ford Motor Co., quoted in *The Wall Street Journal*, August 31, 1989, p. A2.

INTRODUCTION

tions to economic problems is undoubtedly the most inhibiting force in the present curriculum for students of economics. It has led to the increasing isolation of theoretical economists from the day-to-day practitioners of the subject—the actual participants in an economy, the consumers and the producers. It is the growth of *their* knowledge which is all important both for the success of an economy and the validity of any economic theory. And the fact that this knowledge is so widely dispersed and ever-changing lies at the core of much of Hayek's most important work, for example his famous essays, "The Use of Knowledge in Society"⁶ and "The Meaning of Competition".⁷ Yet it is the unpredictable character of the growth of knowledge which requires that from time to time we return our thoughts to the past, to rediscover in the terms set by our original problems whether we are still on course.

We can find no better introduction to the rewards of reading Hayek's historical studies—many of which are collected in this volume, and some of which appear here for the first time in English—than to repeat the gracious acknowledgement given to Hayek by Sir John Clapham in the preface to his definitive history of the Bank of England. "His masterly knowledge of our economic literature has been at my command; and to him I owe a number of pamphlet and press references. His edition of Henry Thornton's *Paper Credit* was always on my table for the period 1780-1820."⁸ The essays in this volume—including Hayek's essay on Henry Thornton—are not printed in chronological order (though for the convenience of students of Hayek's work a table of the contents in chronological sequence is provided), since Hayek was not primarily concerned with establishing a sequential view of economic cause and effect. His concern here, and throughout most of his work, is with the development of concepts and their role in determining the evolution of economic and political order. With an historical context in view we may attempt to escape from the limits of our own parochial assumptions about human behaviour; investigating, as it were, the fossil remains for clues about evolution, to try to evade our own extinction.

Hayek's Vienna was not so lucky. The Great War and the Second World War severed Vienna's links with its former domain. But wars

⁶ In F. A. Hayek, *Individualism and the Economic Order*, Gateway edition (Chicago: Henry Regnery, 1972), pp. 77-91.

⁷ *Op. cit.*, pp. 92-106.

⁸ Sir John Clapham, *The Bank of England* (Cambridge: Cambridge University Press, 1944), p. viii.

are effects as well as causes, and Vienna's links with the former provinces of the Austro-Hungarian empire had already begun to loosen. There is perhaps yet another economic history lesson to be found in causes of the eventual collapse of all the great nineteenth-century empires, one that heretofore has not received sufficient attention, one that might reawaken an interest in economic history and the history of economic theory. Hayek, as we have said, had a keen sense of what mattered. In fact, the primary function of the capital city of an empire, such as Vienna or London, has been to bring together all the information necessary to maintain the political and economic order upon which the survival of the empire depends. Understanding the significance of information was the job of everyone in a capital; their own careers depended on it. But an invention of the nineteenth century changed the world forever in ways that we only now—with the development of the computer—begin to comprehend. Economists of the time did not. Ricardo had changed the focus of economic theory to an investigation of how economic gain is shared among the factors of production. Marx compounded the felony with his focus on industrial production. In fact, the investment of capital in manufacturing is but one of a set of interdependent relations which we might call the *dispersal of consumption*—and, although not identified as such in classical theory, is the necessary condition for the division of labour to be profitable. In short, it was the development of railroads that fundamentally changed the means of production of goods, and necessarily the consumption of those goods. (A thorough discussion of this economic process is beyond the intent of this introduction. However, examples are necessary to understand the importance of our subject, the unlearned lessons of history.)

More important than the railroad, ultimately, was the telegraph. For the first time, information could be conveyed over long distances without something or someone having to be physically transported. Once this possibility existed, the financial, political and military justification for empire vanished. Think of the Roman road and the British navy; think of the early banking families, the Rothschilds, for example; think of the incredible intelligence network of Lloyd's of London.

Now consider the instantaneous transmission of financial information by computer and satellite. And consider why this is valuable enough to have repaid the enormous investment it has required to bring it into being. For an explanation, we can retrace the development of economic theory, to writers before Ricardo, to Adam Smith,