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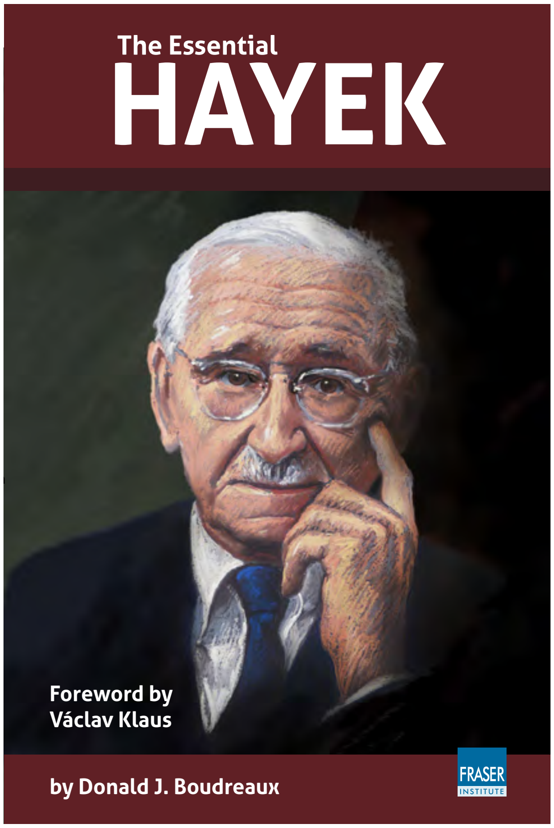
THE BOOK CORNER

THE ESSENTIAL HAYEK

Donald J. Boudreaux



Nobel laureate economist Friedrich Hayek (1899 – 1992) is one of the most influential thinkers of the 20th century and his work still resonates with economists and scholars around the world today. Two decades after Hayek's death, his ideas are increasingly relevant in an era where governments grow ever larger and more interventionist. Written by Fraser Institute Senior Fellow Donald J. Boudreaux, Essential Hayek is a project of the Fraser Institute, comprised of a book, website, and videos that aim to explain Hayek's ideas in common, every-day language.

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ESSENTIAL HAYEK

Nobel laureate economist Friedrich Hayek (1899 – 1992) is one of the most influential thinkers of the 20th century and his work still resonates with economists and scholars around the world today. Two decades after Hayek's death, his ideas are increasingly relevant in an era where governments grow ever larger and more interventionist. Written by Fraser Institute Senior Fellow Donald J. Boudreaux, Essential Hayek is a project of the Fraser Institute, comprised of a book, website, and videos that aim to explain Hayek's ideas in common, every-day language. Here is an excerpt of Chapter 9: The Challenge of Living Successfully in Modern Society.

Part of our present difficulty is that we must constantly adjust our lives, our thoughts and our emotions, in order to live simultaneously within the different kinds of orders according to different rules. If we were to apply the unmodified, uncurbed, rules of the micro-cosmos (i.e., of the small band or troop, or of, say, our families) to the macro-cosmos (our wider civilization), as our instincts and sentimental yearnings often make us wish to do, we would destroy it. Yet if we were always to apply the rules of the extended order to our more intimate groupings, we would crush them. So we must learn to live in two sorts of worlds at once.

—Friedrich Hayek (1988). *The Fatal Conceit.* In W.W. Bartley III (ed.), *The Fatal Conceit, I* (Liberty Fund Library, 1988): 18.

As emphasized throughout this volume, modern prosperity is produced through an astonishingly complex web of human cooperation. This web of cooperation is vast. It spans the globe. Nearly every individual in the modern world is part of it, both as a consumer and as a producer. And so almost all of this productive cooperation is among strangers.

This fact is highly significant for the rules that guide us in our daily activities.

Every day, each of us participates in two very different kinds of productive and valuable social arrangements. One of these arrangements involves interactions with people who we know and care about—our parents, siblings, spouses, children, friends, close neighbours. Call these arrangements "small group arrangements."

The other arrangements are with multitudes of strangers—the millions of people in the great global web of economic cooperation. A small handful of these strangers you see face-to-face, such as the cashier

at the supermarket and the flight attendants on your most recent flight. But the bulk of these strangers—such as the person who sewed the shirt you're now wearing, and the person who designed the shoes now on your feet—are people you'll never lay eyes on. All of these strangers are people you know nothing about. Call arrangements with these multitudes of strangers "large-group arrangements."

One of the greatest challenges to those of us who live in modern society is to be able to function comfortably within *both* types of arrangements. The challenge lies in the fact that behaviours that are appropriate in one of these arrangements are often inappropriate in the other, and vice-versa.

Consider the ultimate small-group arrangement: the immediate family. As in the larger society, within families economic decisions must be made. What's on the menu for tonight's dinner? Who'll cook that dinner and who'll wash the dishes? (Such decisions allocate the family's labour resources.) Where will the family vacation this summer? Should money be spent to remodel the kitchen or should that money be saved for the kids' college education?

Within families, even such "economic" decisions are not made commercially among the members of the family. Perhaps family decisions are made by mutual agreement; perhaps mom and dad alone make all decisions. But regardless of the details of the rules or habits that any particular family uses to reach decisions, normal families do *not* make decisions by using "arms-length" formal contracting, market prices, competitive bidding, or any of the other impersonal procedures that characterize most of our economic relationships with strangers.

The same holds true for decision-making within other small-group settings, such as when friends decide which movie to watch together. The decision is typically reached by informal discussion leading to mutual consent, rather than through bargaining in which the highest monetary bidder gets to choose.

Also within families and many small groups we typically apply egalitarian norms of distribution. The portion of the family's budget that mom has, the portion that dad has, and the portion that each of the kids has is not determined by impersonal market forces. It is instead determined by a strong sharing norm. Within families, income is distributed not only consciously (usually by the heads of the household) but also more or less equally. This sharing norm within families and most other small groups is, of course, praiseworthy.

That we use informal, non-commercial decision-making procedures and norms in small-group settings is a good thing. First, the formalities and competitiveness of commercial procedures are unnecessary in small-group settings. Family members and friends genuinely care about each other and they know each other personally and with a depth of detail that simply cannot exist among strangers. So not only can people in small-group settings rely upon love or mutual concern to prevent cheating; people in these settings also know a great deal about each other. This mutual, detailed, and deep knowledge enables each person to be trusted to act wisely with respect to each other. Parents, for example, generally do not need to be forced by the police to treat their children well. Also, as parents they know their children's desires and abilities well enough that they do not need to learn this information through market competition and prices.

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The close personal connections, the on-going face-to-face communications, and the mutual affections that bind together members of families and other small groups give each member of these small groups such deep knowledge of the other members that no impersonal means of dealing with each other are required.

Second and more importantly, using the formalities and competitiveness of commercial procedures in small-group settings would undermine all that is valuable about those settings. Central to our human nature is our longing and our ability to interact with loved ones and with friends on personal terms—to interact in ways that are built upon particular feelings and expressions of sentiment, caring, and love. Each of us wants to have people to personally care for and to care about, and each of us wants to be loved and cared for personally by other flesh-and-blood individuals. Attempts by parents, say, to charge their children for home-cooked meals, for the time that parents spend nursing their children through illnesses, or for any other benefits and care-giving that parents extend to children would rip from family interactions all that makes those interactions worthwhile and satisfying. Children growing up in such "families" would likely become, at best, social misfits as adults.

With the exception of giving young children an allowance as a way to help them begin to understand how to manage money, the money nexus has little or no place within a healthy family unit. A household run like a business would crush rather than nurture those familial bonds and personal sentiments that are so deeply important to us as human beings. In a world run *only* by arms-length contracting, market competition, money prices, and the formal "thou-shalt-not" rules that we follow when dealing with strangers, intimate relationships, loving families, and close friendships would not exist. Such a world would be worse than cold; it would be inhuman.

Everyone understands the value of personal relationships governed by love and sentiment. Not only are such relationships part of everyone's daily lives, we as a species are also evolved to treasure such relationships and to *know how to engage in them*. Again, parents naturally care for their children; they do not have to be instructed to do so or about how to do so. Likewise, because we humans spent most of our evolutionary history living in small bands of individuals who were known face-to-face to each other—and interacting only relatively rarely with strangers—nearly all of our successful *personal* connections continue to be with the individuals in our small groups.

The sentiments and emotions that bound members of small groups together and best enabled them to survive and to reproduce became encoded in our genes. These sentiments and emotions, therefore, are inextricably part of who we are. They are part of what it means to be human. And although human society in modern times has grown in size far larger than the small groups in which most of our ancestors lived, these small-group sentiments and emotions remain important "guides" to us in our dealings with our loved ones and friends.

As valuable and agreeable as these small-group sentiments and emotions are, however, they are poorly suited to guide us in our connections with the larger society. We cannot possibly know enough about strangers to be able to interact in their lives as intimately as we interact in the lives of people whom we know personally. Also, we cannot possibly care as deeply about the wellbeing of strangers as we care about the well-being of our family and friends.

And yet, to flourish in modern society requires our almost-constant interaction with countless strangers.

And yet, to flourish in modern society requires our almost-constant interaction with countless strangers. To be productive for everyone involved, these interactions must be based on mutual consent and governed by an ethic of kept promises. But these interactions need not be based on feelings of love, caring, and concern. This fact is fortunate because, as just noted, no one is capable of knowing about and caring about more than a tiny number of the individuals with whom he or she interacts daily.

Being guided in our interactions with millions of strangers by impersonal rules and market forces, our capacity for love and concern for others isn't over-taxed. Nor are we called upon to learn the details of the lives of these strangers. When you want to buy, say, a new car, you need to know only some information about the quality of the car and its price in comparison with other cars. The only personal information you need to know when deciding whether or not to buy the car is information about *yourself*. What are *your* tastes and preferences in automobiles? What is *your* price range? What financial arrangements to pay for a car work best for you? You do not have to know—and you cannot possibly know—any such personal information about the millions of individuals whose efforts contributed to the production of the car.

The rules for interacting with strangers overlap with, but are much "thinner" than, the rules for interacting with people whom we know personally. Treat strangers with respect and do not presume that you are a better judge than they are of what is best for them; do not steal from strangers; do not cheat them; initiate no violence against them; keep your promises to them; respect their property rights. To follow these rules requires no personal knowledge of strangers. When people follow these impersonal rules when dealing with strangers in the economy, "arms-length" exchange and contracting occur. These exchanges and contracts give rise to market prices. These prices, in turn, guide each of us to interact productively—as both consumers and as producers—with the increasingly large numbers of strangers who make our modern lives possible.

The success and sustainability of modern society, therefore, requires that each of us be guided by our small-group norms when interacting with people we know personally, yet also to put those norms aside when interacting with strangers.

Switching back and forth between these two sets of very different norms is difficult, especially because we are genetically hard-wired to follow small-group norms. When we see on television or in Internet clips the faces of strangers who are suffering job losses or some other economic misfortune, our small-group norms trigger within us sympathies for these strangers (especially if they share our political nationality). So when government officials promise to "do something" to relieve the suffering, we are inclined to support those efforts, even if we suspect that those efforts will cost us something.

Intellectual reasoning might convince us that the government's proposed efforts won't work, are too costly, or are otherwise unjustified. But insofar as we think of our nation as our extended family, the planned efforts of the government tap into our small-group norms. These norms, thus activated, are often difficult to overcome by those who wish to make unbiased ("rational") evaluations of government policies. For better or worse, even the best rational evaluation is often inadequate to overcome the emotional impulse to consciously tend to those among us who we perceive as suffering.

The power of these small-group norms is especially intense when government presents itself—and is portrayed by the media, by academics, and by popular culture—as being the caring and wise leader of our national "family." In the same way that we would make personal sacrifices to save our children or siblings from economic hardship, "we" as members of the national family, applaud efforts by the leaders of our national family to rescue those among us who have fallen on hard times.

But government policies springing from these small-group norms can be counterproductive. If, for example, government raises tariffs to protect the jobs of domestic wheat farmers, workers in other industries suffer. The reason is that higher tariffs on wheat—by reducing the number of dollars that foreigners earn by selling wheat to us—mean that foreigners will have fewer dollars to use to buy other goods from us (or to invest in our economy). But because these negative effects of the tariff are spread over a large and very diverse number of people, they are more difficult to see than are the benefits of the tariff, which are concentrated on a relatively small, uniform, and easily identified group of people. Being more difficult to see, these negative effects of the tariff don't trigger our small-group sentiments. Those sentiments, in short, bias us toward supporting policies whose beneficiaries are easily seen and whose victims remain cloaked in the complexities of reality.

Similarly, small-group norms of fairness that work well for determining the distribution of goods and resources within families and among friends are inappropriate for judging the distribution of goods and resources in the larger society. The forces that determine the relative sizes of people's bundles of material possessions in market economies are far more complex than are the forces that determine the sizes of people's bundles of resources within small groups.

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In small groups, each person's effort, intent, and simple luck (good and bad) can be observed and taken accurately into account. You know, for example, if your brother's low income is the result of his bad luck or of his choices. (His low income, incidentally, might be the result of his *poor* choices—say, he drinks excessively—or the result of choices that are unobjectionable yet that yield only a low income—say, he chooses to earn his living as a street mime because he enjoys that line of work.) And you and others who know your brother can adjust how you treat him based upon your intimate knowledge of his particular circumstances.

In the larger society, in contrast, such personal observation and knowledge are impossible. No one can know every person's particular circumstances. Nor can we directly observe every person's contributions to the economy as a whole. The best available means of gauging the size of each person's contribution to the economy is to measure the monetary earnings he or she amasses in dealing peacefully in the market with customers, suppliers, and competitors.

The norms that we use in small groups are inappropriate for assessing the merits of the size of strangers' monetary earnings. What *appear* to us to be this stranger's unjustly high income and that stranger's unjustly low income in fact have layers of complex causes that cannot be observed and assessed with the sort of accuracy that we can attain when we observe and assess the justness of how much of a small-group's resources are claimed by each member of that group.

Another difference between small groups and large groups is important here. In small groups we can know with confidence most of the effects on our small group if we redistribute resources from one person to another—say, if mom and dad give Jane a bigger allowance and Joe a smaller allowance. In large groups, in contrast, we cannot trace out the full effects of redistribution. Because we can't comprehend all of the countless unseen interconnections and feedback loops that tie together the choices of millions of individuals from around the globe into the particular outcomes in which some individuals' annual incomes are relatively low while others' incomes are relatively high, we can't know the full effects of redistribution policies. Attempts to redistribute incomes in such complex settings risk triggering many negative feedback loops and upsetting productive arrangements that make even poorer those people with the lowest incomes.

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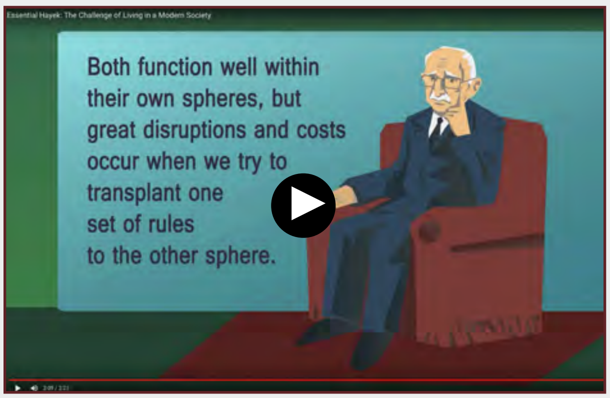
Higher income taxes on the rich, for instance, might diminish private investment so much that over time the resulting loss in economic opportunities for the poorest citizens swamp whatever extra income they receive from government's redistribution policies. Likewise, redistribution might so stymie the incentives of today's poor people to stay in school or to find and keep jobs that the economic well-being of these people is actually worsened over time by the redistribution policies that are meant to help them.

The argument here is not that these particular negative effects will occur. Rather, the argument is that *some* unanticipated negative effects will occur if we try to make outcomes of the large group satisfy the sense of justice and fairness that are appropriate for our small groups. The reason is that our knowledge of the relevant details of the large group—our knowledge of the details of what Hayek called "the extended order"—is puny compared to our knowledge of the relevant details of our small groups. If we try to make the outcomes of the large group satisfy the notions of fairness and justice that are appropriate for small groups, we will dampen and distort the impersonal forces of competition and of profit and loss that are necessary in a large economy to allocate resources to uses that are of maximum value to multitudes of people. We will also weaken the obligation people feel to change their jobs and businesses if consumers no longer value the outputs of these jobs and businesses.



Switching back and forth between small-group norms and large-group norms isn't easy. It's understandable that many people feel a strong desire to apply small-group norms to the large group. Fortunately, however, for the past two or three centuries enough people in many parts of the world have avoided applying their small-group norms to the larger society and economy—or have avoided doing so at least enough to allow global, industrial, bourgeois capitalism to take root and spread. So it *can* be done. People *can* switch back and forth appropriately between small-group norms and large-group norms. Yet media and political commentary daily compound the difficulty of doing so.

In the next and final chapter of this book, we will explore the role of ideas and their inevitably dominant role in determining public policies. If our ideas are "good," they will overcome any sentiments we might have that are destructive to "the extended order." But if our ideas are "bad," the consequence will be policies that undermine and destroy the extended order and, along with it, our civilization.

Learn more about Essential Hayek here

Extracted from Donald J. Boudreaux's The Essential Hayek, *published by the Fraser Institute.*

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