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Hayek's Incomplete Victory

HAYEK'S CHALLENGE:

An Intellectual Biography of F. A. Hayek.

By Bruce Caldwell. Univ. of Chicago Press.

489 pp. \$55

Reviewed by Francis Fukuyama

The intellectual distance the Western world has traversed over the past two generations in how we think about markets, the state, and economic policy is nowhere better illustrated than in the changing reputation of the Austrian economist Friedrich A. Hayek (1899–1992). In the decade after publication of Hayek's tract *The Road to Serfdom* (1944), in which he argued that expansion of the European welfare state was of a piece with spreading totalitarianism, he was regarded as little more than a right-wing crank, a provocateur who dressed up his own normative preferences for markets and individual freedom in the language of science. Today, by contrast, Hayek wears a richly deserved mantle of intellectual respectability. Winner of the Nobel Prize in economics in 1974, he is rightly seen as the intellectual godfather of the pro-market revolution that swept the West with Margaret Thatcher and Ronald Reagan. He has spawned an enormous following that extends well beyond the social sciences.



Friedrich Hayek in 1974

And yet, even those who claim to admire Hayek rarely understand that many of his most important ideas are critical not just of state intervention and planning as practiced by the Left, but of dominant currents in contemporary neoclassical economics as championed by the Right. Bruce Caldwell's impressive new biography pulls together these themes and shows how the second critique logically grows out of the first.

All the threads in Hayek's thought came together in the so-called socialist calculation debate of the late 1930s, in which he and other Austrian school economists challenged the view that centralized planning would yield greater economic growth. In such works as "Economics and Knowledge" and "The Use of Knowledge in Society," Hayek's critique of socialism was, at its core, empirical rather than normative. He argued that human knowledge is inevitably partial: There are limits to rationality, and what any individual knows tends to be local in nature. This is particularly true in a macroeconomy, which depends on

the interactions of thousands, even millions, of individual producers and consumers.

The problem with socialism, Hayek argued, is that it seeks to replace the dispersed knowledge of those myriad actors with that of a single, omniscient planner. Socialist central planning cannot work because it attempts the impossible: using a static equilibrium model to capture unfathomably complex inputs and outputs characterized by dynamic, constantly shifting equilibria. In market economies, by contrast, the price mechanism provides information about preferences and relative scarcities to thousands of agents, whose continual exchanges produce a socially beneficial if unplanned outcome.

At the time of the socialist calculation debate, the Soviet economy was growing rapidly and the capitalist West was reeling from the Great Depression, leading many to consider socialism the superior system. Empirical validation of the Hayek thesis would have to await later decades, when centrally planned economies began to display huge dysfunctions arising from precisely the kinds of informational problems he had outlined. Today, virtually no one believes that the coordinating function of the price mechanism in a free market can be replaced by central planners using even the most powerful supercomputers. And we are much more likely to accept Hayek's broader insight that social order—not simply markets but morality, social norms, the rule of law, and the like—is often the spontaneous and unplanned consequence of the interactions of dispersed individuals with limited knowledge, not the work of a single designer.

But Hayek also offered a far more profound critique of the limits of human reason, which extended to the models that would come to underlie postwar American neoclassical economics and, thus, the economics that we teach university students to this day. Caldwell explains that a constant theme in Hayek's writing—from his early critique of "scientism" in his "Abuse of Reason" project to his last published work, *The Fatal Conceit* (1988)—is a critique not just of real-world planners but of positivist social scientists who aim to turn the study of

human behavior into something as empirical and predictive as the physical sciences.

Like contemporary neoclassical economists, Hayek was a "methodological individualist" who believed that the behavior of groups needs to be explained in terms of the interactions of the individuals who make up the collectivity. But his view of individual choice was far more nuanced and complex than the typical neoclassical model of economic man. He understood that individuals are neither omniscient nor fully rational and are constrained by institutions, norms, and traditions that can be understood only through a study of history.

As Caldwell notes, Hayek initially thought the dividing line between possible and impossible positivism lay in the distinction between natural sciences and social sciences, but by the 1950s he had come to understand that the issue was really one of complexity. A positivist, predictive science is possible only for phenomena, whether human or natural, that are relatively simple—particle physics, for example. One can never fully model and predict complex phenomena such as the spontaneous orders produced by the interactions of simpler agents. These orders include the human brain, whose higher functions cannot possibly be inferred from its physical substratum, as well as ecosystems and, of course, markets, cultures, and other human institutions.

Hayek, in other words, fully anticipated the rise of what we now know as the study of complex adaptive systems, or complexity science. Drawing much of its inspiration from evolutionary biology, this approach is today practiced in such places as the Santa Fe Institute, a multidisciplinary think tank that uses agent-based simulations to model the emergence of complex behaviors on the part of larger collectivities. But Hayek would doubtless disapprove of the research agenda in much of the complexity field, which seeks to use these models to produce deterministic, predictive outcomes.

One of the most interesting parts of Caldwell's book is the epilogue, which quotes Hayek toward the end of his life as saying he regretted his failure to return to his critique of Milton Friedman's *Essays in Positive Eco-*

nomics (1953) as much as his failure to revisit his critique of John Maynard Keynes. Hayek's critique had not to do, of course, with Friedman's preference for markets and limited government, but rather with his belief that economics could be turned into a rigorously empirical and predictive science. Caldwell notes that while econometric methodology has become far more sophisticated, and game-theoretic models ever more complex, economics' promise to cumulate knowledge about universal laws of human behavior has remained largely unfulfilled. Thus, the highly mathematical and ahistorical turn that academic economics has taken in recent years would have been, for Hayek, as much an abuse of reason as the socialist planning of earlier generations.

Hayek's Challenge is, as its subtitle implies, a purely intellectual biography that seeks to interpret the body of Hayek's written work. One finds virtually no details of Hayek's personal life—why he divorced his wife, or how he reacted to being awarded the Nobel Prize alongside the leftist Gunnar Myrdal. Instead, the book begins with a lengthy and informative intellectual history of Austrian economics, touching on such issues as the debate between Carl Menger and Gustav Schmoller of the German historical school. This exposition is critical to understanding the intellectual milieu in which Hayek studied, as well as interesting in

itself because it anticipates the controversies that continue to divide contemporary positivist social science from more historical and ethnographic approaches to understanding things human.

Caldwell, an economic historian at the University of North Carolina at Greensboro, ends his book by plaintively noting that the un-Hayekian agenda of turning economics into a rigorous science has driven all other approaches, including the study of economic history, out of American economics departments. But the damage done by this positivist approach is, in fact, much greater. Economic methodology has colonized political science too, eliminating individuals with knowledge of real peoples, cultures, and history—for example, experts on the Middle East—from the country's top schools. We are thus presented with a rather depressing picture of human progress. Although the particular brand of intellectual hubris that elevated central planning over markets is gone, other forms persist, and indeed have grown stronger. Hayek's challenge remains an open one.

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Cities by Design

*THE NEW CIVIC ART:
Elements of Town Planning.*

By Andrés Duany, Elizabeth Plater-Zyberk, and Robert Alminana.
Rizzoli. 384 pp. \$85

Reviewed by Witold Rybczynski

A title such as *The New Civic Art* raises the question, What was the *old* civic art? The answer lies in *The American Vitruvius: An Architects' Handbook of Civic Art* (1922), a 298-page practitioners' atlas of urban design. More than a glossary and less than a primer, *Civic Art*, as it was popularly

known, includes some 1,200 plates—town plans, building plans, diagrams, drawings, sketches, photographs—culled from a multitude of sources. The authors, Werner Hegemann, a German city planner, and Elbert Peets, an American landscape architect, made no attempt to provide a continu-