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From Smith to Menger to Hayek

Liberalism in the Spontaneous-Order Tradition

— ◆ —

STEVEN HORWITZ

Lately, thinkers from both the political left and the political right have increasingly been making critical comments about the Enlightenment and the political liberalism normally associated with it. Many of these criticisms center around the concern that the tradition of Enlightenment liberalism portrays human beings as hyperrational or extremely atomized. The critics deem the view of knowledge and social interaction they associate with Enlightenment liberalism to be out of touch with more recent conceptions of human agency and community. Such criticisms, however, tend to conflate the various strands of Enlightenment liberalism. In particular, the critics have too little awareness of the work of thinkers associated with the liberal tradition emerging out of the Scottish Enlightenment. The differences between the Scottish variant of Enlightenment liberalism and the English and French versions render the Scottish version more immune to some of these criticisms. Specifically, the Scottish tradition's emphasis on spontaneous order and its conception of market exchange as a form of communication give it a distinct approach worth exploring.¹

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1. My task in this article is not to explore and contrast all the various strands of the Enlightenment, although doing so would be a valuable project. Here, I aim simply to explore the continuity among the thinkers associated with the Scottish tradition and to defend that tradition against some of the criticisms I have noted.

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This version of liberalism can be understood as *both* a research program in the human sciences (the traditional social sciences plus history, philosophy, linguistics, and the nonbiological aspects of psychology) and a political philosophy focused on the relationship between the individual and the state. Of course, the two parts are connected because the political philosophy tends to flow out of the social-scientific analysis. More specifically, this tradition is centered around the concept of *spontaneous order*. Spontaneous orders are the products of human action but not human design. They comprise practices, rules, institutions, and so forth that have developed not because human actors rationally foresaw their likely benefits and deliberately, consciously constructed them, but rather because they are unintended consequences of various human actors' pursuit of their own purposes and plans.

This theme is most pervasive and best developed in the work of three theorists, one from each of the last three centuries: Adam Smith in the eighteenth century, Carl Menger in the nineteenth, and F. A. Hayek in the twentieth. These three theorists belong to a continuous line of intellectual inquiry that constitutes a distinct approach to social analysis and to the discovery of the most desirable political order. As their work shows, a spontaneous-order approach to the study of human action leads to a focus on three issues: the limits of human reason arising from the inarticulate nature of much human knowledge; the institutional arrangements that evolve to enable humans to make use of dispersed and tacit knowledge; and the processes that hamper or foster the evolution of such institutions.

The Spontaneous-Order Research Program of Smith, Menger, and Hayek

As a research program, liberalism in the spontaneous-order tradition attempts to understand how social formations can arise as the unintended consequences of human action. At a more philosophical level, it offers reasons why we should expect to find that those social formations are the results of human action but not of human design. The conception of the individual shared by the most important thinkers in this tradition suggests that the limits to human knowledge and reason necessitate the use of social institutions to achieve social order. At a less-general level, this version of liberalism tries to understand how current and past social institutions have arisen as spontaneous orders and how they have served to coordinate human actors' diverse plans and preferences. Research in this tradition offers explanations of the operations of such institutions in terms of their enabling us to overcome the limits to our individual knowledge and shows how such institutions have emerged and evolved historically.

Adam Smith

This tradition began in the eighteenth century with the original group of thinkers associated with the Scottish Enlightenment: Adam Smith, Adam Ferguson, David

Hume, Bernard Mandeville, and others. Smith's much maligned metaphor of the "invisible hand" has become the most commonly recognized emblem of the reasoning associated with the tradition. In fact, though, Smith used the term *invisible hand* only three times in his major works. However, the same idea appears explicitly in the work of Ferguson and Mandeville, and it is strongly suggested in various places by Hume and the other Scottish thinkers. All these thinkers shared the conviction that people could be taken as they are and that, with the appropriate institutions, society could both ensure against people's worst behavior and channel their self-interest so that it would benefit others, if only unintentionally. In the famous passage invoking the invisible hand, Smith argued:

By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it. ([1776] 1976, 477–78)

In Smith's view, the need to rely on self-interest as a motivator for desirable unintended consequences increases as social relationships become less personal and more anonymous. In dealing with people one knows well, sympathy and fellow feeling would be stronger, and one would know more about what sorts of things would benefit the other. Prior to his famous discussion invoking "self-love" as the elicitor of the products provided to us by the butcher, the baker, or the brewer, Smith offered an explanation of why appeals to self-interest are necessary:

A puppy fawns upon its dam, and a spaniel endeavours by a thousand attractions to engage the attention of its master who is at dinner, when it wants to be fed by him. Man sometimes uses the same arts with his brethren, and when he has no other means of engaging them to act according to his inclinations, endeavours by every servile and fawning attention to obtain their good will. He has not time, however, to do this on every occasion. In civilized society he stands at all times in need of the co-operation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons. ([1776] 1976, 18)

The appeal to self-interest is our best way to convince others to do what we wish when we do not know them well enough to appeal to their fellow feeling for us.

Altruism is often discussed as a motive for individuals to act in ways that benefit others. A bigger issue faced in an anonymous social order, however, is how one gains knowledge of what would best serve the interests of others. In a face-to-face group,

such as an extended family or a tribal group, such knowledge can be readily obtained, but in the more anonymous world of “civilized society,” direct knowledge about the “other” is almost always unavailable. For this reason, Smith found appeals to self-interested exchange both necessary and beneficial.

It is also of note that Smith linked the “propensity to truck, barter, and exchange” with the “faculties of reason and speech” ([1776] 1976, 17). Both are forms of persuasion. For Smith, the problem was how to convince others to do what we wish. Reason and speech are one means, a very useful one when the other person is known to us and within speaking or writing range. Inducing the other to act out of self-interest is another means, a necessary one when the other we seek to convince is among the many anonymous others of a broad social order. (Smith was speaking here of what both he and Hayek [1973] called “the Great Society.”) As we shall see in the much later work of Hayek, the notion of market exchange as a form of communication became central to Hayek’s version of the liberalism that emerged from the Scottish Enlightenment. However, from the beginning of this tradition, it was clear that the issue of how to ensure social order in an anonymous world was central. “In this sense, Smith’s entire program may be viewed as his trying to understand how people construct morals and institutions which make self-interested cooperation among distant strangers a productive and beneficial activity” (Young 2000, 108).

It is important to note that Smith and the other Scots did not think that the beneficence of the invisible hand operated in all circumstances. Rather, the channeling of self-interest into the social good would occur only with the right social institutions. Self-interest could, and in fact did in the mercantilist systems Smith was criticizing, lead to harmful consequences. Where, in Smithian terminology, the positive law does not conform with the laws of justice, the possibility exists that self-interest will cause social harm. As Young argues, “Indeed bringing positive law into conformity with the laws of justice is the central policy problem of *The Wealth of Nations*” (2000, 105). When that conformity obtains, the benefits of a self-interested division of labor will be fully reaped.

Despite Smith’s crucial insights, his ability to understand and explain the spontaneous-ordering processes of society and the role of institutions in facilitating them was limited by the constraints of classical economics, especially by the cost-of-production theory of value. Escape from that limitation had to wait another hundred years.

Carl Menger

The next major advance in this tradition came with the work of Carl Menger, writing in Vienna in the 1870s. As the history of economics is normally told, Menger, simultaneously with William Stanley Jevons in England and Léon Walras in Switzerland, discovered the principle of marginal utility. Of the three, Menger gave the greatest emphasis to the role of subjective evaluation. Whereas Jevons and Walras focused on marginal utility as a mathematical concept (the first derivative of a total utility func-

tion), Menger concentrated on explaining how human valuation set in motion the competitive discovery process of the market. In his *Principles of Economics* ([1871] 1981), Menger clearly explained how market prices, as well as other market phenomena, emerge as unintended consequences of subjective evaluation processes. In his account, he showed how the market arrived at prices, rather than positing possible prices and constructing demand and supply schedules from them, as in the modern practice. As the economist Hans Mayer ([1932] 1994) argued, Menger's theory is a theory of price formation, not of price determination.² It pertains to the market process, not to a mathematical equilibrium.

In his *Investigations into the Method of the Social Sciences with Special Reference to Economics* ([1883] 1985), Menger defended this approach as part of a broader research program in the social sciences. For that contribution, he deserves to be considered the outstanding nineteenth-century representative of the spontaneous-order tradition of liberalism that originated with the eighteenth-century Scots. In *Investigations*, he posed what is sometimes called the “Mengerian” question: “How can it be that institutions which serve the common welfare and are extremely significant for its development come into being without a common will directed toward establishing them?” ([1883] 1985, 146). This is but a somewhat amplified statement of the Scots' invisible hand idea. Menger sought to provide what he termed “compositive” explanations of social and economic institutions, as opposed to “pragmatic” explanations, which focus on how particular institutions have been intentionally designed for particular purposes.

Menger's famous theory of the origin of money serves as a paradigmatic spontaneous-order explanation. It deserves a brief review because it illustrates several key parts of the Mengerian approach to social science and also exemplifies what Mayer called a “genetic-causal” theory rather than a “functional” theory ([1932] 1994, 57). People who wish to trade but have no money will first attempt to barter, but the absence of a double coincidence of wants will make barter difficult. Eventually some actors realize that they will be more likely to make trades if they can acquire goods that *other* people desire. So begins a process of cultural interpretation in which various people attempt to understand the subjective preferences of others. Those who acquire goods that have greater subjective value to more “others” will make more exchanges more easily and thus become “wealthier.” As they do, their choices will be observed and imitated by others, who will also start trying to use those same goods as media of exchange. As the number of media becomes smaller, the demand for each grows, making each one that much more suitable as a medium of exchange. After some time, this process converges to one good (or maybe two) that is subjectively highly desired and can meet the minimal physical requirements of a money (relatively scarce, storable, portable, divisible). Ultimately, the good that remains is considered a generally acceptable medium of exchange, or money.

2. See the discussion in Vaughn (1994, 26, n. 21) and the sources cited there.

Notice the spontaneous-order elements of this account. Money is a product of human action, not human design. The only behavioral assumptions we need to make are that people will trade to acquire the goods they wish to consume and that they prefer to make those trades as easily as possible. The actors need never be conscious of the fact that they are helping to create money. In fact, how could they be, if they do not even know what money is? The institution of money is thus an unintended consequence of human action (exchange). Or, more precisely, human action initiates a discovery process that results in the creation of an institution that none of the actors could have intended or perhaps even imagined. Menger's theory starts with the notion that valuation arises from the subjective perceptions of individuals and ends with an emergent institution that is thoroughly social. Once money emerges, it, like all other institutions, constrains behavior by virtue of the advantages of participating in an intersubjectively created institution.

Although Smith and his Scottish colleagues understood this process in its broadest outlines, Menger began to fill in some of the details. In particular, Menger bridges the gap between Smith and Hayek by reorienting Smith's discussion of economic progress away from the division of labor alone and toward knowledge more broadly. In the opening chapter of *Principles*, he begins his discussion of the causes of economic progress with a review of Smith, then points out that the division of labor alone cannot explain all economic progress. He concludes that discussion by arguing that "Nothing is more certain than that the degree of economic progress of mankind will still, in future epochs, be commensurate with the degree of progress of human knowledge" ([1871] 1981, 74). With that recognition, Menger pushes the Scottish tradition forward toward Hayek.³

F. A. Hayek

Hayek would carry this tradition even further in the next century. His extension of the main ideas would take two important forms. First, he provided an epistemological backdrop for spontaneous-order explanations, and for liberalism more broadly, at which the Scots and Menger only hinted. Second, he clarified the role played by economic institutions, particularly market prices, in bringing about the spontaneous-ordering processes of the market and of the social world more broadly.

Hayek's main contribution to the liberal tradition begun by the Scots was to emphasize the epistemic limits to humanity's ability to design and direct our institutions and their outcomes consciously. For Hayek, the problem of creating an economic or social order arises from "the fact that the knowledge of the circumstances of which we must make use never exists in a concentrated or integrated form but solely

3. Menger also connects to the Scottish political economists of the early twentieth century, who, with a deep interest in the Austrian tradition spawned by Menger—studying, for example, translations of Eugen von Böhm-Bawerk's publications—continued to work along Smithian lines. I thank Alastair Dow for bringing this point to my attention.

as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess” (1945, 77). Knowing precisely how resources should be allocated or what sorts of social practices or norms would serve us best would require that we bring together in one place the bits and pieces of knowledge that separate people, families, or firms possess. Hayek argued that the relevant knowledge they possess simply *cannot* be centralized in the hands of one person or group who could then make determinations of what is better or worse. To the contrary, what is needed is a set of institutions that enable the possessors of knowledge to make that knowledge socially available for use by others in forming their own plans and intentions. For Hayek, the problem of social and economic order is a problem of communication, and the human condition is one of partial, fragmentary, and often incorrect knowledge. We need ways of communicating that allow us to learn from each other and through such learning processes to discover progressively better ways of doing things. This vision accords with Smith’s insight, noted earlier, that exchange is an extension of reason and speech.⁴

Hayek complicated this view, however, by adding another level. He argued, especially in his work after World War II, that some of the knowledge required for, say, optimally allocating resources exists in a form that cannot be communicated by means of statistics or language. As part of his lifelong criticism of those who wished to apply the methods of the natural sciences uncritically to the question of social order, Hayek pointed out that objective, articulable knowledge, including economic statistics, was not the only kind of knowledge relevant for economic activity. He first made this point clearly in 1945, when he emphasized the role of “the knowledge of the particular circumstances of time and place” (80). Much of the knowledge relevant for social coordination is, in Hayek’s view, inherently contextual.

In his later work, Hayek added that much of the relevant knowledge might be tacit and therefore not even potentially articulable. For example, most people know how to keep their balance on a bicycle. In doing so, they are implicitly solving some fairly complex physics equations, yet hardly anyone can articulate, much less solve, those equations as he rides. More mundanely, consider that even young children can speak grammatically correct sentences without having been explicitly taught any rules of grammar. At issue here is Gilbert Ryle’s famous distinction between “knowing how” and “knowing that.” Knowledge of the former sort pervades the social world. The problem is to find a means, even though neither natural language nor mathematics can serve to do so, of making such knowledge available to others so that they can make use of it.

In the context of economics, Hayek showed that competition within well-structured legal and political institutions provides a way for this communication process to take place because the prices generated by market competition serve as socially accessible proxies for tacit as well as objective knowledge. When actors make

4. The idea of monetary exchange as an extension of language is explored in greater depth in Horwitz 1992.

decisions to buy and sell, they are communicating—through action rather than by means of written or spoken words or numbers—their knowledge and preferences concerning the goods in question. The movement of prices in one direction or the other provides indirect access to other people’s knowledge and allows actors to coordinate their behavior with that of others without the need for centralized direction. As Hayek argued in 1945, market prices bring “about the solution which (it is just conceptually possible) might have been arrived at by one single mind possessing all the information which is in fact dispersed among all the people involved in the process” (86). In other words, the price system enables us to generate order spontaneously by providing us with an institutional process for overcoming the unavoidable dispersion, context specificity, and tacitness of our knowledge.

The Role of Institutions in the Scottish Tradition

The role of institutions has become a central topic of modern work in the spontaneous-order tradition emerging out of the Scottish Enlightenment. Smith, Menger, and Hayek recognized that because the size and anonymity of modern society preclude our gaining detailed knowledge of all but a few others, we need to coordinate our social behavior by the use of norms, rules, and institutions. In the words of Ludwig Lachmann, “institutions, as understood in the Weberian tradition, enable each of us to rely on the actions of thousands of anonymous others about whose individual purposes and plans we can know nothing. They are nodal points of society, coordinating the actions of millions whom they relieve of the need to acquire and digest detailed knowledge about others and form detailed expectations about their future action” (1971, 50). Lachmann ties the role of institutions into our previous discussion of fragmented and context-specific knowledge. He suggests that Weber’s theory of institutions represents all economic and social institutions as communication processes that make our diverse, often tacit knowledge socially usable.

This aspect of institutions figures prominently in modern work that views institutions as “interpersonal stores of coordinative knowledge” (Langlois 1986c, 237). Institutions limit what we need to know in order to act successfully; they allow us to form more accurate expectations about the behavior of others without detailed knowledge of them. If everyone agrees—whether explicitly or tacitly—on a particular practice, we no longer have to outguess or outstrategize other actors. The classic example of such so-called coordination problems is deciding which side of the road to drive on. As long as all agree, the particular choice is irrelevant. A rule about which side to drive on reduces the need to make a fresh choice on a case-by-case basis. By removing some elements of social interaction from conscious deliberation, institutions free us to focus on other matters that lack institutional solutions: “the existence at higher levels of institutions that stabilize the environment and reduce environmental entropy effectively frees behavioral entropy for use at lower levels. In a stable regime, the agent’s reliability is high enough that he can add new actions to his reper-

toire . . . at lower levels” (Langlois 1986a, 186–87). By serving as coordinative nodes, institutions reduce the knowledge needed to execute our plans and therefore enhance our ability to execute those plans successfully.

How do institutions come into being? Many emerge as the unintended consequence of successful individual rule following. That is, not only do institutions contribute to the larger spontaneous order of society, they are themselves often spontaneous orders. In trying to improve their conditions, individuals construct plans of action and attempt to carry them out. They will continue to use modes of behavior that are successful and will treat them as “rules of action” for how to behave in certain circumstances. To the extent that others can observe the ways of behaving exhibited in the successful plans, they will imitate those ways, increasing the number of actors behaving in those particular ways. As this imitation process continues and the number of users of particular rules increases, people learn to expect similar behavior from others. A larger number of rule followers makes using the rule more attractive to potential newcomers because more users implies more opportunities to use the rule as a predictor of behavior, enhancing the likelihood of coordinated outcomes.⁵ When the behavior in question is so widespread that we can call it “generally accepted,” the rule has become a social institution. As Lachmann explains, “Successful plans thus gradually crystallize into institutions. . . . Imitation of the successful is, here as elsewhere, the most important form by which the ways of the elite become the property of the masses. . . . Institutions are the relics of the pioneering efforts of former generations from which we are still drawing benefit” (1971, 68). Obviously, this statement is only a generalization of Menger’s theory of the origin of money discussed earlier.

Once such institutions are in place, they constrain our behavior, if not our very ways of thinking, in important respects. We are born into a social world of various norms, rules, and institutions into which we are socialized from an early age. We learn to form expectations of others’ behavior based on those regularized practices. As the modern literature on institutions argues, by limiting our range of both thought and action, institutions actually liberate us by making it easier for us to anticipate correctly the actions of others. Although, in a sense, having to drive on the right (in the United States) limits our freedom, it also makes us freer by eliminating the need to figure out where people are going to drive on a case-by-case basis.

Broader institutions such as language and money have similar effects. Having been “born into” a language, we see the world in the terms—words and other utterances—of that language. We cannot “get outside” the language to perceive some nonlinguistic “reality.” Of course, this same apparent constraint is actually quite liberating in that the regularity of language facilitates communication. Likewise for money

5. This process of learning through experience reflects the broadly empiricist view of knowledge that all three thinkers held. The point is expressed most clearly by Hayek (1952), who views mental categories as the product of human interaction with the external world. Both Hayek and Smith were quite “Humean” in their epistemologies. The links between Hayek’s view of the mind and his work in political economy are explored in Horwitz 2000.

and the institutions of the market in general. Monetary exchange resembles the use of language in that it constrains how we can think about value and other economic concepts. This connection between monetary exchange and linguistic communication is a running theme of work in the Scottish tradition of liberalism.

Scottish Enlightenment Man

Critics of Enlightenment liberalism often point to Thorstein Veblen's account of how he understood the emerging models of turn-of-the-century neoclassical economics to view human beings: "The hedonistic conception of man is that of a lightning calculator of pleasures and pains, who oscillates like a homogenous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. He has neither antecedent nor consequent. He is an isolated, definitive human datum" ([1898] 1919, 73). Veblen attempted to portray critically the newly emerging economics as a Newtonian and mechanistic approach to the study of society that should be abandoned for a more evolutionary and institutionally grounded approach.

Unfortunately, Veblen's mocking caricature of *Homo economicus* is indeed often approximated in modern-day neoclassical economic models, and it is a depiction rightfully scorned by its critics. However, no one is warranted in leaping from a well-justified criticism of the neoclassical conception of human actors to the conclusion that *everyone* working in the tradition of Enlightenment liberalism embraces such a conception. The spontaneous-order tradition employs a different, much more realistic conception of human actors. As Richard Langlois observes, the irony of Veblen's attack was that one of his targets, Menger, "was laying the groundwork for a very fruitful approach to the evolutionary and the institutional" (1986b, 4). Veblen homogenized the marginal revolutionaries much as the critics of Enlightenment liberalism homogenized it. As a result, he never saw that the view of human nature he was attacking "fit Jevons's or Walras's theory much better than [it did] Menger's" (Jaffe 1976, 521).

This argument can be clarified by recalling the nature of human beings as depicted in our discussion of institutions. There, human beings are hardly atomistic, hyperrational, utility maximizers. Instead, they are products of the institutional environment in which they operate. Rather than merely lamenting the limitations so imposed and longing for a world free of influences that we cannot control, the adherents of the liberalism emerging from the Scottish Enlightenment explore how, from another vantage point, those same limitations are in fact liberating. In a world where knowledge is dispersed, context specific, and often tacit, institutions are *necessary* for the emergence of any sort of social order. People will always be social products; we simply have to accept that we can never be wholly the products of our own conscious construction.

In the view of the three thinkers under discussion, human beings are not repositories of hyperrationality. They are error prone, often short-sighted, and frequently in need of guidance by the knowledge of others. As Hayek argued in his later work

(1988), even their capacity for reason itself is a product of cultural institutions. Jaffe's description of Mengerian man fits this whole tradition: "Man, as Menger saw him, far from being a 'lightning calculator,' is a bumbling, erring, ill-informed creature, plagued with uncertainty, forever hovering between alluring hopes and haunting fears" (1976, 521). In all three thinkers' work, human beings are hardly seen as atomistic and narrowly self-interested. In fact, one wonders what the word *atomistic* means in the writings of the critics. If it means something such as "human actors have no attachments to other humans or human institutions," then it is wrongly ascribed to the vision of humanity held by the Scottish tradition of liberalism. In *The Theory of Moral Sentiments* ([1759] 1976), the foundation of Smith's conception of human morality is the faculty of sympathy. Mengerian man is understood to be molded by the institutional environment in which he moves. Certainly Hayek does not view human beings as the unconnected, narrowly self-interested maximizers of Veblen's caricature.

Speaking of how the Scottish thinkers used the term *self-interested*, Hayek argued in 1946: "These terms [*self-love* or *selfish interests*], however, did not mean egotism in the narrow sense of concern with only the immediate needs of one's proper person. The 'self' for which alone people were supposed to care, did as a matter of course include their family and friends; and it would have made no difference to the argument if it had included anything for which people did in fact care" (13). Hayek continued with an explanation of why it still made sense to assume that humans are self-interested in a *broad* sense: "Far more important than this moral attitude . . . is an indisputable intellectual fact which nobody can hope to alter and which by itself is a sufficient basis for the conclusions which the individualist philosophers drew. This is the constitutional limitation of man's knowledge and interests, the fact that he *cannot* know more than a tiny part of the whole society and that therefore all that can enter into his motives are the immediate effects which his actions will have in the sphere he knows" (1946, 14). The phrase "sphere he knows" is understood to include family, friends, and the like, not just the "self" narrowly construed. Once again, this appreciation of the "sphere he knows" harkens back to Smith and the continuum he laid out between how one acts toward those one knows well and how one acts toward anonymous others. In our interactions with those close to us, we can more easily invoke fellow feeling and other relevant dispositions that are less reliable as we move toward interactions with those less known to us or not known at all.

Moreover, unlike neoclassical economics and the traditions of liberalism that make use of it, liberalism in the spontaneous-order tradition does not rest on any belief about the rationality of human actors. In fact, the case for this kind of liberalism is predicated on our ignorance. Because so much of our knowledge is tentative, fragmented, and tacit, we require the use of spontaneously evolved social institutions to generate social order. Spontaneous-ordering processes are communication procedures that enable us to overcome our very narrow and partial views of the world and

to make use of the differently partial and narrow knowledge that others possess. In this tradition, it is not the individual actors that are best described as “rational,” but the processes in which they operate.

Liberalism as a Political Position

The liberalism of the Enlightenment, sometimes called *classical* liberalism and today best expressed by the term *libertarianism*, holds that in order to create “the wealth of nations” or to better the condition of individuals in other ways, it is not necessary for the state do anything more than protect rights to life, liberty, property, and the pursuit of happiness. State intervention beyond those limits is counterproductive and, by violating the stipulated rights, will diminish people’s ability to achieve their own ends. In short, state intervention makes people worse off.

In contrast to other classical liberal or libertarian writers, relatively few in the Scottish tradition have posited a priori natural rights. Modern libertarianism—which remains largely rooted in the Lockean and Hobbesian, more English, variant of the Enlightenment—is dominated by related rights talk: state intervention is bad because it violates one’s right to X. For many libertarians of this school, once one has made a case for individual rights, then state intervention is ipso facto bad because it immorally violates those rights.

For writers in the Scottish tradition, the central issue is not rights but consequences. Smith argued for free trade because it would increase the wealth of nations and, in so doing, would make people better off. He also wrote about rights and the system of “natural liberty,” but they are seen as desirable because they produce good consequences; they are not inviolable in all circumstances. At many places in *The Wealth of Nations*, Smith deviated from the system of natural liberty because he regarded the consequences of natural liberty as problematic. Moving forward in this tradition, we encounter almost no discussion of rights, certainly not natural rights, in Menger’s work. Like Smith, Menger was interested in economic development and how markets would promote it and the larger betterment of humanity. Hayek’s mentor in economics, Ludwig von Mises, who was a much more ardent opponent of state intervention than Hayek, concurred with Jeremy Bentham’s characterization of natural rights as “nonsense on stilts.” And Hayek himself—although constantly torn between his Scottish heritage, in the form of a Humean love of the empirical, and his Germanic debts to Kant, in the form of a real concern with freedom and generalizable rules—rarely talked about rights.⁶ In the Scottish tradition, the arguments for free markets, freedom of expression and association, and international peace are consequentialist: allowing spontaneous-ordering processes to do their job is desirable because such processes *work*; they make for a more prosperous, happier world than do the alternatives.

6. See Kukathas 1990 for more on Hayek’s attempts to reconcile Hume and Kant.

The key guiding political principle for this branch of liberalism is a recognition of the limits of human rationality and of our ability to design top-down solutions to social problems. It might seem somewhat ironic that a branch of Enlightenment liberalism would treat the limits of reason and rationality as foundational, but this view traces back to Hume's claim that he wished to "use reason to whittle down the claims of reason."⁷ Nothing in the ideal of the Enlightenment commits one to applying the methods of physical and biological science—so powerful and productive in the material domain—to the social world. The mindset of the scientist or the engineer is inappropriate for solving human problems. The social world is constituted by the subjective evaluations of human actors, often based on their inarticulable or time- and place-specific knowledge and informed by their oft-conflicting values. To believe that certain people, themselves uniquely conditioned by context and history, might successfully design a top-down, one-size-fits-all solution for millions of other people stretches the imagination beyond its limits.

Instead, solutions emerge in multiple forms as a result of the bottom-up activities of people with the sort of detailed, context-specific knowledge that enables them to serve the needs of those around them in finely tailored ways. More important, according to the spontaneous-order tradition, when we allow the competitive forces of markets and culture to generate solutions, we can rely on the feedback mechanisms of those spontaneous-ordering processes to weed out the failures and to select what actually meets people's needs.

One of the major differences between the liberalism of Smith and Menger and the liberalism of Hayek is that Hayek had access to and was an important participant in one of the great intellectual debates that brought together the research program and political concerns of the liberal tradition: the debate over the possibility of economic calculation under socialism that took place in the years between the two world wars.

In response to the arguments of earlier socialists such as Karl Marx and of twentieth-century writers such as Otto Neurath, Ludwig von Mises ([1920] 1935) launched the debate with his article on economic calculation in the socialist commonwealth. He argued that without private property in the means of production, socialist planners, whether a small group or a more democratically organized polity, would have no way to determine how effectively they were using resources. In the absence of private property in capital, there would be no market for capital goods and therefore no prices for capital; hence, planners would be deprived of an irreplaceable guide in determining what to produce and how to produce it. In deciding how to apply a particular capital good to produce various consumer goods or how to produce a given consumer good by using various capital goods, planners without genuine market prices determined by exchanges of private property would be groping in the dark.

7. As Hayek wrote, "By 'reason properly used' I mean reason that recognises its own limitations and, itself taught by reason, faces the implications of the astonishing fact, revealed by economics and biology, that order generated without design can far outstrip plans men consciously contrive" (1988, 8).

Mises's argument cut to the heart of socialist claims about the productive superiority of planning. Whereas socialists had long seen the market as irrational and anarchic, Mises's argument showed how the seeming anarchy of production gave rise to a rational economic order when actors could make use of market prices to guide their decisions.

Later refinements of this argument by Hayek and contemporary economists working in the spontaneous-order tradition have stressed the same sorts of epistemological issues raised in the discussion of liberalism as a research program. These economists claim that when government officials intervene in the market, they do so largely blind to the intricate details and context-specific and tacit knowledge that shape the market. As Smith wrote in the paragraph after his reference to the invisible hand: "What is the species of domestic industry which his capital can employ, and of which the produce is likely to be of the greatest value, every individual, it is evident, can, in his local situation, judge much better than any statesman or lawgiver can do for him. The statesman [would] assume an authority . . . which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it" ([1776] 1976, 448).⁸ Clearly, the focus on the context specificity of knowledge and the difficulties of communicating such knowledge "to the top" dates back to the earliest contributions to the Scottish Enlightenment.

In this tradition, markets are a communication process that enables us to extend human communicative action beyond language and mathematics to the realm of the tacit. Market prices perform a semiotic function in communicating the kinds of knowledge we often have difficulty articulating. Interfering with or eliminating market processes deprives participants of the full benefits of the market "conversation." In modern terms, markets are "communicatively rational." As the philosopher Gary Madison has noted, "The market economy can be said to be irrational only to the extent that one entertains an overly *rationalistic* conception of rationality, one which in fact reduces reason to mere instrumental, means-end (utility maximizing) rationality. . . . Monetary transactions are of a communicatively rational nature; they are not . . . purely utilitarian and instrumentalist. Monetary transactions are an extremely important way in which citizens of a civil society carry on their society-constituting interactions with one another" (1998, 135, 137, emphasis in original). The argument that planners would not be able to engage in economic calculation in the absence of money prices suggests that what market processes do is to generate orderly outcomes, without design, by the use of those prices.

The Misesian critique of planning presupposes a vision of the market radically different from that associated with both mainstream economics and the other strands of Enlightenment liberalism. The market is not the arena in which atomistic maximizers blindly collide, hoping against hope to produce some sort of optimal static

8. See also Smith's famous "chessboard" passage in *The Theory of Moral Sentiments* ([1759] 1976, 233–34).

equilibrium outcome. Rather, it is part of the human conversation, a process through which we overcome the limits of our minds and engage in cooperative behavior to create, produce, and exchange. By providing others with indirect knowledge via market prices, we allow them to make use of that knowledge and construct their plans accordingly. This process permits the ever finer degrees of division of labor and knowledge associated with economic growth. Those finer divisions of labor and knowledge require that increased amounts of cooperation must take place in order for consumer goods to be produced. In this light, the Mises-Hayek argument against planning can be seen also as an extension of Smithian insights about the progressive division of labor, refined by both the epistemological issues raised by the subjective theory of value and the importance of monetary calculation as stressed in the calculation debate.⁹

Conclusion

The liberalism rooted in the Scottish Enlightenment points toward a different conception of both the task of the social sciences and the most desirable economic and political order. Unlike the more rationalistic conceptions of humans and their social world associated with other strands of liberalism, the Scottish variant recognizes human fallibility and the subjective, tacit, and context-specific nature of much of our knowledge. It further recognizes the inherently social nature of human beings: in order to survive, we must cooperate with others. However, adherents of the spontaneous-order tradition argue that such cooperation need not and to a high degree *cannot* be intentional, planned cooperation. They emphasize how much of our social world has emerged as unintended consequences of human action. The social world arises from “human action but not human design.” The market is the foremost example. In the Scottish tradition, the market is seen as a set of institutions that facilitates our (often erroneous) attempts at social coordination. It is in that way an outgrowth of our faculties of reason and speech, as Adam Smith argued more than two hundred years ago. The market allows us to communicate with millions of anonymous others in ways that extend our human capacity to persuade others in direct face-to-face encounters and by the use of language.

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9. For an interpretation of the calculation debate that stresses the role of money, see Horwitz 1998.

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