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Where does Hayek draw the line?

The agenda of government and the inescapable impurity of Hayek's market society

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(Provisional version. Please do not quote)

You [Hayek] admit here and there that it is a question of knowing where to draw the line. You agree that the line has to be drawn somewhere, and that the logical extreme is not possible. But you give no guidance whatever as to where to draw it.

John Maynard Keynes, *Letter to F. Hayek*, 1944

Our thesis is that the idea of a self-adjusting market implied a stark utopia. Such an institution could not exist for any length of time without annihilating the human and natural substance of society.

Karl Polanyi, *The Great Transformation*, 1944

1. Introduction

F. A. Hayek is considered one of the most important intellectuals of the so-called 'intransigent right' in the twentieth century (Anderson, 2005). Nevertheless, it should be noted that, as Shearmur (1996: 26-32) has argued, in his youth Hayek, perhaps under the influence of his teacher Friedrich von Wieser, expounded "mildly socialist views". These views, especially from the early twenties onwards, an epoch when he became part of Ludwig von Mises' circle, all but disappeared and Hayek's intellectual trajectory was then seemingly built around a "visceral hostility to socialism and the need to fortify it

with intellectual underpinnings” (Mirowski, 2007: 358). Indeed, Hayek’s arguments on issues of comparative political economy are said to be based on a “Manichean assumption” that there can only be two antagonistic political doctrines – liberalism and socialism – which provide arguments for two seemingly uncontaminated and irreconcilable socioeconomic systems (Kley, 1994: 3). There is obviously ample evidence to support the view, put forward, among others, by Hodgson (1999) and Ioannides (2000), that Hayek was always reluctant to concede that some degree of impurity is necessary for any viable socioeconomic system¹. This can be seen from his contribution to the famous socialist calculation debate up to his often repeated argument that planning in a mixed economy, which tries to combine institutional arrangements from socialism and capitalism, is an unstable and inefficient “muddle”. A “muddle” which would, more or less rapidly, degenerate into a totalitarian socialist system unless a liberal project of reconstructing the basic institutions of capitalism could gain the ideological and political upper hand.

Nevertheless, and according to Caldwell (2004: 288-292), Hayek was led in his discussions with “socialists of all parties” to the conclusion that the liberal tradition that he was arguing for was in need of a serious restatement of its principles. This led him, or so it will be argued, to an understanding of capitalism which had to admit, and even to argue for, important forms of impurity. This restatement had also to supersede the widely-shared interpretation that liberalism was nothing but the result of a *laissez-faire* attitude to socioeconomic and political affairs which led to an intransigent, but ultimately untenable, defence of the so-called “minimal state”. It also had to turn what in the forties Hayek saw as fairly general, and exceedingly vague, liberal principles about the nature and scope of the fundamental institutions of capitalism into a more concrete set of guidelines capable of defining what would become for him the fundamental question of the political economy of liberalism: “to distinguish between the agenda and nonagenda of government” (Hayek, 1948a: 17). The following quotation nicely encapsulates both of Hayek’s (1948b: 110-111) concerns in this area:

¹ Geoffrey Hodgson (1999: 126), squarely within the “original” institutionalist tradition in economics, has put forward the “impurity principle” to reflect the idea that “every socioeconomic system must rely on at least one structurally dissimilar subsystem to function”.

While it would be an exaggeration, it would not be altogether untrue to say that the interpretation of the fundamental principle of liberalism as the absence of state activity rather than a policy which deliberately adopts competition, the market, and prices as its ordering principle and uses the legal framework enforced by the state in order to make competition as effective and beneficial as possible – and to supplement it where, and only where, it cannot be made effective – is as much responsible for the decline of competition as the active support which governments have given directly and indirectly to the growth of monopoly (...) That a functioning market presupposes not only the prevention of violence and fraud but also the protection of certain rights, such as property and the enforcement of contracts, is always taken for granted. Where the traditional discussion becomes so unsatisfactory is where it is suggested that, with the recognition of the principles of private property and freedom of contract, which indeed every liberal must recognize, all issues are settled (...) It is only after we have agreed on these principles that the real problem begins.

This “real problem”, pointed out in the first meeting of the Mont Pelerin Society, is one Hayek was already aware of at least since the end of the thirties when he wrote *Freedom and Economic System* (1939), a pamphlet that anticipates many of the arguments that he would further develop in *The Road to Serfdom* (1944). It is a problem that, in many ways, constitutes the bulk of *The Constitution of Liberty* (1960) and which also runs through his three-volume work *Law, Legislation and Liberty* (1973, 1976, 1979). It is a problem that led Hayek to consider that the question of the relation between the state and markets in capitalism was one which could not be framed by the dichotomy of intervention versus non-intervention argued for by the “old formulae of laissez-faire” since, among other things, the state was an unavoidable element in the constitution and protection of any viable and evolving socioeconomic system (Hayek, 1960: 202). A letter that John Maynard Keynes (1980: 386-387) wrote to Hayek in 1944 appraising *The Road to Serfdom* is sometimes used as a signpost of the main challenges that the approach he favoured had to face in this regard²:

I come finally to what is really my only serious criticism of the book. You admit here and there that it is a question of knowing where to draw the line. You agree that the line has to be drawn somewhere, and the logical extreme is not possible. But you give no guidance whatever as to

²This letter is mentioned in the literature that purports to analyse the relation between Keynes and Hayek. On this see Carabelli and Vecchi (1997), Shearmur (1997) and Skidelsky (2006). Furthermore, and according to recent analysis put forward by Burczak (2006: 39), Caldwell (2004: 289) and Shearmur (2006: 149), Keynes’s challenge, among other criticisms, is said to have played a role in Hayek’s subsequent research agenda which led him to define the legitimate area for public policy as the one that was compatible with the rule of law. This is of course particularly evident in *The Constitution of Liberty*.

where to draw it. In a sense this is shirking the practical issue. It is true that you and I would probably draw it in different places. I should guess that according to my ideas you greatly underestimate the practicability of the middle course. But as soon as you admit that the extreme is not possible, and that a line has to be drawn, you are, on your own argument, done for, since you are trying to persuade us that as soon as one moves an inch in the planned direction you are necessarily launched on the slippery path which would lead you in due course over the precipice.

Keynes's challenge has the merit of calling our attention to the fact that there is in Hayek (1944: 40) a "wide and unquestioned field for state activity" which is seemingly at odds with his intransigent arguments about the "muddle of the middle" and the totalitarian tendencies that loomed in the efforts to reform capitalist economies. If Hayek was led by this challenge, as it is sometimes implied, to develop a particular new set of arguments about the criteria of demarcation between the legitimate and non-legitimate roles of the state is questionable. In fact, it can be argued that the arguments that support Hayek's efforts at demarcation, although developed and expanded, maintain, at least when one compares the *Road to Serfdom* with *The Constitution of Liberty*, a high degree of constancy in their overall nature. This means that the problems pointed out by Keynes maintain all their pertinence even in Hayek's latter work.

The discussion about the agenda and non-agenda of government also introduces further and more powerful arguments for the efforts to de-homogenize the contributions of Hayek and Mises³. The position that Mises took on the scope and functions of the "minimal state" could perfectly be signaled as an example of what Hayek had in mind when he concluded that a liberal research agenda had to move beyond general formulas as embodied in the defense that the state should "simply" be concerned with the "protection of life, liberty and property" (Hayek, 1948a: 17). That Hayek and Mises have a different position on this crucial issue has of course been noted. For example, and not surprisingly given his libertarian position, Fred Block (1996: 339-340) considers that Hayek was, "at best", a "lukewarm" and "unprincipled" supporter of "laissez-faire capitalism". Mises, on the other hand, "made far fewer compromises with state intervention into the economy than did Hayek" (Block, 1996: 365). This seems non-contentious, but it also lacks a proper explanation for the differences in both

³ This has been mainly made with regard to the arguments they developed against socialism in the context of the socialist calculation debate. See, for example, O'Neill (1998) and Salerno (1994).

authors' approaches. Hayek's conscious refusal of expressions such as "laissez-faire" and "intervention" to describe his position on the role of the state is not a mere question of playing with words and has wider implications because it implies a very different position about the nature and dynamics of capitalism and about the theoretic and philosophical positions that could ground its defense⁴.

This article identifies some of the areas in which Hayek considered the presence of the state to be irreplaceable. It is thereby concentrated on the identification of the positive agenda for government in Hayek's thought and not so much on his better known and scrutinised criticisms directed at the political economy and philosophy of the "socialists of all parties". The second section presents Hayek's criteria of expediency, which seems to presuppose some sort of cost-benefit analysis, that underlies his evaluation of public policies within the overall framework of the rule of law. The idea of the rule of law, developed in *The Constitution of Liberty*, but already hinted at the *Road to Serfdom*, is said to fix the boundaries within which the state should operate. The third section discusses Hayek's views on the importance of "planning for freedom" or "planning for competition", expressions that he uses in *Freedom and Economic System* and in *The Road to Serfdom* to draw a distinction between the need for the state to establish a framework of rules and regulations that may guarantee and foster market competition and forms of state planning that would only thwart and eventually destroy it. The fourth section introduces Hayek's recognition of the existence of "neighborhood effects" and interdependencies that seem to be one of the sources of the permanent challenges to existing systems of property rights. It also considers the problems posed by "public goods", discusses their inescapable political and moral nature and the demands that this creates for non-market forms of provision. The fifth section then tries to discuss what might be called the "knowledge problem" in Hayek's agenda for government. By this two things are meant: on the one hand, Hayek's own admission that there are certain forms of knowledge which require the existence and sustenance by the state of non-market institutional arrangements; on the other hand, the recognition that state authorities must possess access to some forms of knowledge, capable of being

⁴ Actually, both Mises and Hayek concur that the term "intervention" is best reserved to those areas of government involvement in the economy that go beyond their desired agenda. The question is that their agenda is a different and so are some of their arguments.

centralized, about the workings of the economic system and about the expectable consequences of certain collective decisions. The sixth section presents Hayek's conception of the "service state" and his views on the need for a "social safety-net" that could provide for those who, for several reasons, found themselves "outside" the market.

It will become clear, and this is also a purpose of this article, that the themes developed around the relation between markets and the state show, as it has been emphasized by Shearmur (1997), a more "constructivist" and "rationalist" side of Hayek's thought, which he never abandons throughout his own career⁵. The conclusion then tries to systematize the main sources of impurity in Hayek's model of capitalism showing that his own arguments not only presuppose a capitalist economy characterised by a fair degree of institutional plurality, but also open avenues through which one might argue that the increase of the institutional impurity of capitalism cannot, contrary to what might be expected, be easily blocked by the intellectual fences that Hayek has tried to built.

2. Drawing lines: 'expediency' bounded by liberal principles?

According to Hayek, the emergence of the process of market competition, as the dominant, but never exclusive, form of economic interaction among actors, was dependent on the previous existence of appropriate social rules (Fleetwood, 1996). The rule of law not only provides a framework, an organising principle, to those rules that are explicitly part of Hayek's political architecture of a market society to be guaranteed by government, but also seems to underpin the line that Hayek wants to draw between the agenda and non-agenda of government itself (Burczak, 2006; Sheramur, 2006). Indeed, Burczak (2006: 39) argues that Hayek conceives the rule of law as the "arbiter of the boundary between appropriate and arbitrary government action" and that as "long as public policy is consistent with the rule of law, property rights and market exchanges

⁵ Hayek (1944) was criticised by the conservative Michael Oakeshott (1962: 21-22) precisely for the "rationalist" and "doctrinaire" elements that "infected" his work: "This is, perhaps, the main significance of Hayek's *Road to Serfdom* – not the cogency of his doctrine, but the fact that it is a doctrine. A plan to resist all planning may be better than its opposite, but it belongs to the same style of politics".

will be insulated from politics and discretionary public policy”. Although one of the roles of the rule of law is indeed to reduce the encroachment of discretionary public policies upon the functioning of markets, the agenda of government, which Hayek thought compatible with his understanding of the rule of law, does open some avenues which might put into cause the possibility or even the desirability of achieving this type of insulation.

The rule of law, one of the main themes of *The Constitution of Liberty*, is then understood by many as Hayek’s reply to the question posed by Keynes about the crucial issue of where to draw the line between the legitimate and the illegitimate roles of government (Shearmur, 2006). Even if this interpretation is correct, two things should be noted. Firstly, the idea of the rule of law, as the main underpinning of a liberal society concerned with the promotion of freedom as the absence of undue coercion of an individual by another individual, group of individuals or by the state, is already present in *The Road to Serfdom* where Hayek tries to show its utterly incompatibility with socialist planning. Secondly, the rule of law, given its mainly formal character, does not seem so much to give a clear indication of where precisely to draw the line, in terms of the activities that a government might undertake, but mainly of how to draw it, so as to assure that certain patterns of human interaction and forms of state intervention are blocked. Its task therefore seems to be mainly a negative and procedural one: “a government which can apply coercion to the individual citizen only in accordance with pre-established long-term general rules but not for specific, temporary ends is not compatible with every kind of economic order. If coercion is to be used only in the manner provided for in the general rules, it becomes impossible for government to undertake certain tasks” (Hayek, 1960: 168).

A brief sketch of the nature of the rule of law in Hayek (1944, 1960) seems to confirm that one of its functions is to frame the way public policies might be pursued. Hayek conceives the rule of law as a framework of rules, which have to be enforced by the coercive powers of the state, itself clearly circumscribed by rules, endowed with certain formal attributes. The rules have to be stable and devised, as far as possible, with the objective of enduring for long periods of time. They have to be announced in advance and enforced accordingly to what was previously established. Their evolution and

change must be carefully calibrated and gradual, thereby ensuring a high degree of predictability in order not to disturb and disappoint individuals' expectations. Furthermore, they have to be universally applied, meaning that it must be guaranteed that the law will apply equally to all individuals who find themselves in the same circumstances. The rule of law is said to provide the best guarantee that individuals will be able to pursue their own ends, using the means that are at their disposal, including among them an environment where uncertainty and unpredictability, about the avenues that are legally open and close to them and to the individuals with whom they will directly or indirectly interact, are reduced to maximum possible extent (Tomlinson, 1990).

The rule of law, as Hayek understands it, still leaves ample room for the menu of seemingly diverse and potentially antagonistic deliberate public policies to which we will allude below. These aim at giving a concrete form to the main task of a liberal government: "to provide a favorable framework for individual decisions; [to] supply the means individuals can use for their own purposes" (Hayek, 1960: 195). Indeed, the agenda of government that is compatible with the rule of law seems to authorize policy initiatives that help to create and then shape, albeit in a piece-meal and incremental fashion, the institutional framework that underpins markets, thus engendering potentially alternative allocation of rights and obligations among different actors. But it authorizes more than that since the rule of law is compatible with a wide array of policy initiatives which introduce a certain degree of impurity in Hayek's model of capitalism. These will have an impact, intended or unintended, on the results thus obtained and on the resources thus controlled by individuals who occupy different social positions, not only inside, but also outside markets. Hayek tries systematically to underplay the importance of these issues by reducing those public policies, which he considers to be compatible with the rule of law, to a matter of expediency: "as long as they are compatible with the rule of law, they cannot be rejected out of hand as government intervention, but must be examined in each instance from the viewpoint of expediency" (Hayek, 1960: 194). This appeal to expediency seems to square well with Hayek's view of the state as "piece of utilitarian machinery" (Hayek, 1944: 80). This means that its involvement in a capitalist economy is to be assessed by a seemingly impartial evaluation of the net benefits, in terms of welfare, as foreseen by those whose task is to

decide and implement them. It is not clear, though, what criteria can be agreed upon and used here since Hayek's own subjectivist framework seem to preclude their emergence.

3. "Planning for competition" or markets as instituted processes

Already in 1939 Hayek claimed that one of the crucial tasks ahead for liberalism was to distinguish planning as a defining element of socialism, to which it was vehemently opposed on epistemological and political grounds, and planning as an unavoidable element of any viable market society. In order to draw this crucial line, Hayek (1939: 193) felt that it was "necessary to clear away the mist of confusion and ambiguity which enshrouds the term 'planning'" and to understand that the sources of its ambiguity, but also of its attraction, came from a widely shared desire to apply reason to solve important social problems.

Hayek thereby uses the expression "planning for freedom" to convey the possibility of using reason to "plan a system of general rules, equally applicable to all people and intended to be permanent (even if subject to revision with the growth of knowledge) which provides an institutional framework (...) in which individual initiative is given the widest possible scope" (Hayek, 1939: 194). The importance of the rule of law was already hinted at. This form of planning implied creating the conditions to enable market prices to be the main mechanism of coordination, something which involved the recognition that the market was the only device which was capable of mobilizing, and relying on, the "knowledge of all participants, with prices conveying to each the information which helps him to bring his actions in relation to those of others" (Hayek, 1939: 194).

In stark contrast with "planning for freedom" was the "planning of the planners of our time" or "planning for constant interference" which involved applying reason to the construction of "some preconceived blueprint" (Hayek, 1939: 144-145). This ultimately implied the destruction "of the only known mechanism by which the knowledge of all can be utilized" and its replacement by a method through which "the knowledge and the view of a few are consistently and exclusively utilized" (Hayek, 1939: 196). This would

have dire political consequences since the control of resources by some central authority, an unavoidable feature of this version of planning according to Hayek, meant that it had the power to determine to a much larger extent the needs that would be satisfied, and the ends and values that would ultimately be pursued.

If this distinction seems clear enough in its broad contours, it is not as clear-cut as Hayek seems sometimes to imply. Indeed, in the very same article, Hayek offers strong reasons for this being a matter of degree. Firstly, the line separating the “construction of a rational system of law” underpinning markets, which would be capable of guaranteeing that the price system would remain intact “in its sphere”, and a “system of specific orders and prohibitions” is not easy to draw in practice (Hayek, 1939: 194). Secondly, and relatedly, for Hayek liberalism had still not developed a proper answer to decisive questions, which ultimately determine the fundamental character of markets, their extension and also, or so one may posit, the broad patterns of relations between individuals and the results that they might thereby expect to obtain: (1) What is the “exact content and the specific limitations of property rights”?; (2) “how and when the State will enforce the fulfillment of contracts”? (Hayek, 1939: 195)⁶. Thirdly, Hayek acknowledges that in even in capitalism “some amount of central planning of this kind [“socialist planning for interference”] is always necessary” because there are “needed services which cannot be priced and therefore will not be obtainable on the market”, which obviously means that they will “have to be provided in some other way” (Hayek, 1939: 197).

The evolving nature of “the spontaneous forces of society”, resulting from the unpredictable patterns of human interaction, which liberalism should treasure, meant that in defining the “rules of the game” that necessarily frame them and also shape their growth and direction, there could be “no hard-and-fast rules fixed once and for all” (Hayek, 1944: 17). Hayek (1944: 18) considers that “the attitude of the liberal towards society is like that of a gardener who tends a plant in order to create the conditions most favourable to its growth”. This metaphor perfectly encapsulates his views on the crucial role of ideas in selecting and shaping the institutions that guide individuals’ behaviours.

⁶ These questions reappear throughout Hayek’s work, only slightly changed, without being thoroughly addressed. See for example Hayek (1944: 39; 1948b: 112-113; 1960: 296; 1982: 109). In section three I will try to explore some of the reasons that might account for this fact in relation to the crucial issue of property-rights.

As Gray (1989: 127) notes, Hayek “sees the principal economic functions of the State as having to do with the maintenance and improvement of the institutions which sustain market processes”. I think that this interpretation is correct if “maintenance and improvement” are interpreted in a way that recognises that the state is prior to markets and is a crucial element in deliberately creating the conditions for their emergence. If this is so, then one can argue that Hayek (1944) is close to consider market competition to be a prime example of what Karl Polanyi (1991), in line with the institutionalist tradition in political economy, would latter call an “instituted process”. It is an instituted process because, at least in societies with an advanced division of labour, markets seem to be the result of a contested political process requiring the intervention of an organized coercive power which, to a certain extent, has to define “specific orders and prohibitions” indicating who can participate, and the conditions in which it can do so, what are the legitimate objects of exchange (i.e. what entities can actually be considered as commodities), and the “rights-obligations structure” that each agent faces when exchanging those commodities (Chang, 2002). Hayek (1944: 39-40) implicitly acknowledges this when he argues that: “The functioning of competition not only requires adequate organisation of certain institutions like money, markets, and channels of information – some of which can never be adequately provided by private enterprise – but it depends above all on the existence of an appropriate legal system” which has to be “intelligently designed and continuously adjusted”.

The legal foundations of markets also involve setting of rules that must continuously be created and recreated “to prohibit the use of certain poisonous substances, or to require special precautions in their use, to limit working hours or to require certain sanitary arrangements” (Hayek, 1944: 38-39)⁷. This is all part of “the most essential prerequisite of its proper functioning, the prevention of fraud and deception (including the exploitation of ignorance)” (Hayek, 1944: 41)⁸. Every functioning market is always

⁷ The expression “legal foundations” is an allusion to John Commons’ important work *The Legal Foundations of Capitalism* (1924). Despite all their differences, Hayek (1960: 200) acknowledges that Commons was one of the few to have paid attention to the crucial issue of “the relation between the character of the legal order and the functioning of the market system”.

⁸ As Block (1996: 345) rightly argues, expressions such as “channels of information” “exploitation of ignorance” are “somewhat obscure” in their implications. Furthermore, they are apparently contradictory with Hayek’s argument about the “epistemic” virtues of markets. As it will be argued bellow, Hayek

unavoidably regulated by the State and the recognition of this particular fact is, most evidently, one of the reasons that grounds Keynes' remarks about the difficulty of drawing clear lines between "planning for competition" and forms of planning which pave the "road to serfdom". It seems that, at least as far as the issue of regulation is concerned, the line cannot be drawn very clearly after all once Hayek acknowledges that "competition can bear some admixture of regulation", although he immediately adds that there is "threshold", which he leaves unspecified, where regulation transforms "planning for competition" into "planning against competition". Nevertheless the above quotation seems to presuppose that regulation is some sort of optional burden which competition has to "bear". As we have already seen, this cannot be so given the role that regulation, broadly understood, plays in Hayek's (1944) own account of markets: it legally defines the "rules of the game" without which no market competition is possible. There seems therefore to exist, scattered throughout Hayek's work, sufficient elements to authorize an institutionalist reading which points to an understanding of the market as an "organized and institutionalized exchange" (Hodgson, 1988: 174).

The way Hayek frames the issues of contracts that ground market transactions, the legal nature of the organisations, specially corporations, that are, most of the times, interested parts in a market relation, or his views of the differences between competition and monopoly offer further arguments to justify this institutionalist reading, albeit tempered by a recognition that there is in Hayek a permanent reluctance to fully explore these issues.

Contracts, as we have already mentioned before, are one of the essential elements of a market transaction. The way contracts are antecedently framed is part of the process of determining, among other things, the character of market relations, and the results that individuals might expect to obtain in them (Finn, 2006). This involves a political decision about the type of transactions that are to be blocked by law and the types which are to be authorized and the ways by which they are to be so (Walzer, 1983). Hayek (1948b: 115) implicitly concedes this when he argues that the liberal slogan of "freedom of contract" is devoid of any practical meaning: "a legal system which leaves the kind

considers markets to be profoundly incomplete in this regard having to rely on, and be supported by, other types of institutions for some forms of needed information and knowledge.

of contractual obligations on which the order of society rests entirely to the ever new decisions of the contracting parties has never existed and probably cannot exist". This, of course, seems to give ample room for "value judgments" which have to be made by those who have the power to define the types of transactions which should be recognized by law (Streit, 1997). Given this view of the contractual nature of market exchange it is very difficult to claim, as Hayek (1944) does, that "planning for freedom" should, among other things, be evaluated by its capacity to "keep prices intact", i.e. let them simply be the result of "free exchange" by individuals, endowed with particular knowledge and desires. The difficulty stems precisely from the fact that the transactions that will determine prices are antecedently shaped by the institutional arrangements of which contracts are a part (Bromley, 2006). Of course, when Hayek speaks about the need to keep prices intact, he is arguing against policies that tried to directly control or fix prices or allocate resources through non-market means, but this seems to preclude him from inquiring into the ways that alternative institutional arrangements conducive to market competition generate different constellations of prices.

The role that "value judgments" play in framing the conditions for market competition is also evident in Hayek's view of corporations as creations of law. In fact, although Hayek is rather parsimonious when talking about one of the most fundamental non-market organizations in capitalism, he does argue that its shape, nature and evolution are basically a product of decisions taken by policy-makers. Hayek constantly links this issue with the nature and scope of contracts, the origins of monopoly and the nature of competition⁹. Indeed, when discussing the growth of the corporation and the monopolization of important economic sectors, Hayek (1944) argues that these are not the inevitable result of incontrollable and unavoidable technological processes, but the result, on the one hand, of policy induced "artificial" barriers to entry in an increasing number of sectors and, on the other hand, the consequence of the way law has provided undue advantages to corporations by giving them rights which should be reserved to the "natural person" (Hayek, 1948: 116). It is in the context of a discussion about these processes that Hayek (1944: 50) has one of its most idealistic formulations: "the

⁹ See for example Hayek (1944: 45-58, 1948b: 115-116 and 1960: 230-232)

intellectual history of the last sixty or eighty years is indeed a perfect illustration of the truth that in social evolution nothing is inevitable but thinking makes it so”.

This last formulation shows Hayek’s belief that the institutional conditions of a competitive market order can be nurtured by appropriate legislative policies, the product of a particular and malleable “climate of opinion”, which itself is also shaped by law. It is therefore crucial for Hayek (1944: 204) that “the monopolistic organisation of industry” ceases to be promoted and becomes instead the “whipping boy of economic policy”.

Nevertheless, Hayek’s “optimistic” view about the possibility of competition means that permanent monopoly, the only cause of concern in this area, can become a rare and innocuous situation, but only if a vaguely defined set of institutional arrangements are adopted which seem to presuppose a “strong [and autonomous] state” capable of blocking the potential abuses committed by corporations which may tend to avoid competition by demanding all sorts of particular protections. Hayek’s view of the conditions that must be reunited for competition to operate are in fact quite general and seemingly undemanding. They can only be understood having his particular view of the “market process” in mind. Hayek (1948c) always distanced himself from the “static” view of perfect competition focused on the conditions which guarantee that “equilibrium” is reached at the outset – “complete knowledge about the relevant facts”, large number of sellers and buyers which are assumed to be price-takers of a perfectly homogenous commodity or “free-entry” and perfect price flexibility (Hayek, 1948c: 95). He considers that this way of thinking about market competition not only blinds economists to its real features and advantages as an open-ended and dynamic process of rivalry, but also directs them to a vain search to reengineer markets so as to try to create those unattainable conditions, something which runs the risk of destroying competition as it can exist in the real world.

Instead, Hayek (1948c: 101) considers that one should learn to judge competition in markets as the best way available to solve the economic problem of society which is “always a voyage of exploration into the unknown, an attempt to discover new ways of doing things better than they have been done before”. If this is so then “planning for

competition” is less about imposing “perfect competition”, then about pragmatically guaranteeing that “there is competition at all” (Hayek, 1948c: 105). For Hayek (1944, 1960) this seem to rely on the capacity of the state to guarantee that no individual or organization is barred, provided that certain general conditions are met, from entering into a particular market. But, as Streit (1997: 43) has argued “with freedom to compete as the frame of reference instead of an ideal competitive process, identifying restrains of competition becomes more a matter of value judgments than it may have been before”. This is mainly so because, as Streit (1997) and Palermo and Palermo (2005) have noted, the static conception of efficiency ceases to be useful to evaluate what it is essentially an open-ended process in which a final state never seems to be reached¹⁰. Barred “force or fraud”, themselves concepts open to interpretation and dispute, Hayek optimistically considers that monopoly is always a temporary phenomena bound to be threatened by potential competitors. This threat is itself said to be sufficient to prevent all forms of “abuse” and to assure the existence of the indispensable “bracing air of competition” (Hayek, 1944: 200). But since he acknowledges that monopoly can be a permanent feature of certain sectors – as in the case of “public utilities” – he has to rely on the aforementioned “strong state” to impose forms of discipline and regulation that curb private forms of power.

In this section, we have looked at certain features of Hayek’s thought about markets as institutions structured by the power of a state which has to “plan for competition”.

Hayek’s position on this issues can summarised by Kenneth Arrow’s dictum: “the definition of property rights based on the price system depends precisely on the lack of universality of private property and of the price system” (quoted in Hirsch, 1976: 193).

Let us now analyse Hayek’s views of situations that are conventionally, and inaccurately as I shall argue, thought under the label of “market failures” – “externalities” and “public goods”.

¹⁰ This means, as we shall see bellow, that Hayek’s own views about the nature of market processes seem to preclude the definition of any clear-cut criteria to evaluate their welfare properties. The same can be said of other institutional arrangements.

3. Public goods and externalities as sources of political and moral dilemmas

Hayek always considered the market to be a necessarily incomplete mechanism of provision. It not only needs a set of background conditions, to be assured by the state, but it is also incapable of providing certain goods and services without which no viable capitalist society can be said to exist. In reality, as it has been emphasised by several commentators¹¹, Hayek seems implicitly to adhere to a “market-failure” type of reasoning since he recognizes that there are public goods, i.e. goods, which seemingly due to their intrinsic characteristics, cannot be provided through “the competitive system”¹². The following formulations are representative of Hayek’s (1948b: 111) views on this issue and they are often repeated throughout his work:

We must, of course, not forget that there are in a modern community a considerable number of services which are needed (. . .) and which could not be possibly be provided by the market for the obvious reason that no price can be charged to the beneficiaries or, rather, that it is not possible to confine the benefits to those who are willing or able to pay for them.

In the context of this discussion, Hayek (1944: 40) frequently mobilises Adam Smith’s famous justification for the existence of an agenda for government, to support his argument:

To create conditions in which competition will be made as effective as possible, to supplement it where it cannot be made effective, to provide the services which, in the words of Adam Smith, ‘though they may be in the highest degree advantageous to a great society, are, however, of such a

¹¹ See, for example, Kley (1994: 86) and Jasay (1996: 112).

¹² A public good, as conceived by conventional economic theory, is an ideal-type construction exhibiting two main features which supposedly capture the characteristics of an important range of goods: (1) there is ‘no-rivalry’ in the consumption of the good since its use by one individual does not diminish the quantity that is available for others; (2) there is no possibility of excluding from the consumption of the good those that have not paid for it. Giving the assumption that individuals are selfish and make decisions on the basis of a computation of the costs and benefits for themselves of different courses of action, a strategy of free-riding on others’ contributions would prevail and therefore individuals would be trapped in a situation where the public good is not provided, or at least not in the quantities desired, if they rely on “voluntary” mechanisms of a market-like nature. Given this situation, there emerges a powerful argument to use the “coercive” apparatus of the state to oblige individuals to contribute, through the tax system, to the provision of public goods or, alternatively, to assure, whenever possible, the creation of a costly and well-defined property rights regime to assure the possibility of exclusion which means turning the public into a private good (O’Neill, 2006).

nature, that the profit could never repay the expense to any individual or small number of individuals', these tasks provide indeed a wide and unquestioned field for state activity.

The examples to which Hayek alludes also tend to repeat themselves: "such are most sanitary and health services, often the construction and maintenance of roads, and many of the amenities provided by municipalities for the inhabitants of cities" (Hayek, 1960: 196)¹³. Jasay (1996: 112) has criticised Hayek for accepting "the text-book division of the universe of goods and services into two exogenously determined halves, public and private". He further argues that in reality "there is no such exogenous division" because "over the universe of goods exclusion cost is a continuous variable. Where society draws the dividing line between public and private goods is an endogenous decision". (Jasay, 1996: 112). Although these important remarks help to clarify the potential sources of Hayek's ambiguity in this regard, they seem to miss his own admission of the impossibility of drawing a clear-cut line between private and public goods. Indeed, Hayek recognizes this when he argues that "we shall find that in some measure this kind of case shades somewhat gradually into those in which the whole of the services rendered can be sold to whoever wants to buy them. At some stage or other we shall certainly have to consider which services of this kind we must always expect governments to provide *outside the market*" (Hayek, 1948b: 111-112).

Furthermore, and as his own examples illustrate, Hayek is aware of the political and normative conundrums that can be raised in this regard, although he is also committed to avoid them to the maximum extent possible. It is worth emphasizing that Hayek seems to use expressions such as "cannot be priced" or "no price can be charged" to try to reduce the existence of public goods to a seemingly technical problem which impairs their provision through the market. This problem of course stems from the impossibility, or at least the difficulty, of excluding from the enjoyment of the good those that do not have paid for it. But even if the criteria of nonexcludability could be made somehow operational, it is still very much dependent on a previous political decision regarding which goods of this type a community decides to provide because it

¹³ The case for the state-sponsored provision of some kinds of information and knowledge, which Hayek also seems to accept, could also be considered under the heading of the public good idea, but as they also rise particular problems of their own, it is better to treat them separately.

understands that they “are needed” and, as importantly, what are the amounts, distribution and particular forms that their provision should assume. Hayek uses the rather undefined, and potentially elastic, concepts of “collective wants” or “highly desirable public goods” to allude to this unavoidable political element (quoted in Jasay, 1996: 112). Furthermore, and to complicate matters even more, Hayek sometimes refers to goods and services which ought not to have a price given the prevailing understanding, among the majority of the members of particular political community, about them and about the way they should be provided (Hayek, 1939, 1960). The mere recognition that this may offer valid reasons to introduce non-market elements in their provision process has of course huge implications for the scope and extension of markets. Gray (1989: 112) seems therefore to be in firm ground when he claims that Hayek is never “specific about whether these public goods would have to satisfy technical criteria joint provision and non-excludability, but it is apparent from his discussion of detailed cases (. . .) that he does not intend the publicness of public goods to be construed too strictly”.

This means that other criteria seem to enter into Hayek’s account of public goods. In this context, one might refer to Anton’s (2000) distinction between the two senses that the word public good has acquired in the literature. And both seem to be present in Hayek’s work. According to the first, public goods are “bound up with market society and the institutional underpinnings of such a society” (Anton, 2000: 3). This implies that they are simply a functional appendage that assure the proper working of markets. This idea of public goods seems to encapsulate most of Hayek’s concerns in this area, although it is also far from clear how to draw clear lines here. According to the second sense, public goods are conceived as a commonstock, i.e. “social property from which, like a public park, we have a right not to be excluded” (Anton, 2000: 4). The examples of public parks and other urban amenities to which Hayek (1960: 226) alludes imply a recognition of the existence and importance of this second category.

Given this fact, there is a further distinction, recently put forward by O’Neill (2006), which might be useful to try clarify the sources of Hayek’s dilemmas. One can then conceive a public good as conventional economic theory has done – where the impossibility of exclusion appears as more or less essential feature of the good in

question – or, alternatively, one can explicitly introduce a moral dimension in this discussion by referring to normative public goods, i.e. those goods which are understood in such a way that it is realized that nobody should be excluded from their use (O’Neill, 2006). In reality, “while the senses are distinct, arguments that a certain good is a public good in the economic sense sometimes seem to be used as a surrogate way of defending the public nature of the good which for quite distinct reasons is believed to be a normative public good which ought to be nonexcludable” (O’Neill, 2006: 51). I think that Hayek sometimes uses this strategy precisely to try to circumvent the normative discussion. But once this unavoidable element is uncovered, then the expressive dimension of the way certain goods are provided, regardless of the way their particular characteristics make their exclusion more or less difficult or more or less costly, becomes clear: “The goods that any community defines as normative public goods from which members should not be excluded define the relationships of need and mutual obligation that are constitutive of that community” (O’Neill, 2006: 52).

The above definition is of course part and parcel of an open-ended and contested political process whose frontiers cannot be decided a priori by taking refuge on a type of reasoning which tries to present this question as if it was part of a purely technical and depoliticised exercise. A careful reading of Hayek makes clear that, his functionalist arguments notwithstanding, public goods are an additional avenue contributing to blur the clear lines he sometimes would like to draw between the “agenda and non-agenda of government”.

As it is common in mainstream economics, Hayek’s discussion of public goods is embedded in the wider problem of externalities, i.e. the consideration of the effects an actor’s action can have upon other actors, either detrimental or beneficial, which, giving the existing institutional arrangements, do not seem to be taken into consideration by the actor who has generated them because they were not transmitted by the price system (Barry, 1979; Bromley, 1989). This points precisely to the important issue of the nature and scope of interdependencies and how the institutional arrangements of a given society are set to manage them (Samuels, 1992). Here is how Hayek (1944: 39-40) frames this issue:

There are, finally, undoubted fields where no legal arrangements can create the main condition on which the usefulness of the system of competition and private property depends: namely, that the owner benefits from all the useful services rendered by his property and suffers from all the damages caused to others by its use (...) In such instances we must find some substitute for the regulation by the price mechanism.

This seems to presuppose that externalities, calling for some sort of state-sponsored regulation, only arise whenever it is not possible, through a proper definition of property rights, to confine the costs or benefits of certain actions to the actor who is responsible for them. Given a certain structure of incentives, “where there is a divergence between the items which enter private calculation and those which affect social welfare”, and certain assumptions about individuals’ motivations and knowledge of the impact that their actions have upon others, Hayek seems to accept that “harmful effects” like “smoke or noise of factories” will, in the absence of deliberate governmental action, tend to be higher than otherwise would be the case (Hayek, 1944: 40). Of course, precisely the contrary tends to happen when one considers beneficial effects for which the actor responsible for them is not somehow compensated. Property rights, however defined, cannot always be expected to do the job of generating the appropriate incentives to make economic actors “internalize” all socially relevant externalities. Furthermore, private solutions, according to which people may be “willing to submit to the damage for an agreed compensation” do not seem to be capable of solving most of the problems in this regard (Hayek, 1944: 40).

Once again Hayek is not at all clear about the pervasiveness of this type of phenomena nor about the merits of the alternative forms that are available to remedy them. But he accepts that this is one of the main areas where the market system fails to generate appropriate results. And this recognition, as Block (1996: 347) has argued, is a veritable “Pandora’s box” which “once open it is logically impossible to close again” because externalities are a ubiquitous and unavoidable feature of economic and social life where interdependency is rife since every action will always have an impact on others (Samuels, 1992: 92). Furthermore, and to make matters still more complicated, the patterns of externalities are themselves a function of a previous allocation of legal rights which by determining the legitimate avenues for human action influence the interdependencies that will be generated (Samuels, 1992). This means that “the

elemental questions of policy are: whose interests, whose freedom, whose capacity to coerce, who may injure whom, whose rights and who decides? Nowhere are these problems more obvious and important than in the matter of externality solutions” (Samuels, 1992: 99). Therefore, externalities are not a mere residuum to be taken by the state, but are part and parcel of what is involved in the policy-making process of defining what costs a certain actor has to take into account in the activities he develops and what costs he can impose on others: “This struggle between those causing costs – and those on whom they fall – is at the heart of conflicts of the legal foundations of a market economy” (Bromley, 2006: 63-65).

The ubiquity of externalities broadly conceived is actually recognised by Hayek when discussing the problematic nature of precisely defining the contours of individuals’ “private sphere” to be protected by law and not be interfered with (Hayek, 1960). Hayek (1960: 127) rejects John Stuart Mill’s criteria of grounding its definition on the distinction between the actions that only have an impact on the individual itself and the actions that have an impact upon others, precisely because “there is hardly any action that may not conceivably affect others”. This issue is thereby much more difficult to settle since “in determining where the boundaries of the protected sphere ought to be drawn, the important question is whether the actions of other people that we wish to see prevented would actually interfere with the reasonable expectations of the protected person” (Hayek, 1960: 127). Of course, the process of determining the reasonableness of expectations is bound to be a matter of hard to solve political dilemmas which cannot be settled by any indisputable criteria.

Nowhere are these problems clearer than in the area concerned with the definition of property rights which are said to be part and parcel of the individuals’ private sphere to be protected by the state. Hayek reveals an understanding of the tremendous implications this issue has for the liberal case given the complex interplay between externalities and property rights. This clearly contradicts some of his more confident formulations about the conditions that have to be reunited for private property rights to correctly guide individuals’ decisions – that all relevant costs and benefits of their actions must fall within the private boundaries defined by law –, and the extent to which this situation can be in practice achieved:

Where the law of property is concerned, it is not difficult to see that the simple rules which are adequate to ordinary 'mobile' things or 'chattel' are not suitable for indefinite extension. We need only turn to the problems which arise in connection with land, particularly with regard to land in modern large towns, in order to realize that a conception of property which is based on the assumption that the use of a particular item of property affects only the interests of its owner breaks down. There can be no doubt that a good many, at least, of the problems with which the modern town planner is concerned are genuine problems with which governments and local authorities are bound to concern themselves (Hayek, 1948b: 113).

There are at least two issues at stake here. Firstly, there is the thesis that the importance of "neighbourhood effects" tends to increase with the growth of cities (Hayek, 1960). Secondly there is the recognition that this more or less unavoidably generates new dilemmas for public policy. These have to do, as indicated above, with definition of the fundamental institutional underpinnings of the economy since "the costs involved in large numbers living in great density not only are very high but are also to a large extent communal, i.e., they do not necessarily or automatically fall on those who cause them but may have to be borne by all". In this context, Hayek is willing to do little more than reaffirming the challenges that this poses for the liberal program: "The general formulas of private property or freedom of contract do not therefore provide an immediate answer to the complex problems which city life rises" (Hayek, 1960: 296). But he concedes that the complex problems of externalities seem to call for some forms of town planning which are capable of transcending the atomization created by narrowly defined private property rights through a reallocation of some elements of "the bundle of rights we call 'property'" to some planning unit, public or private, which is capable of better managing these "neighborhood effects".

Perhaps to avoid discussing some of the most vexing issues in this area, namely the criteria used to define how these rights are to be allocated among the contending parties and how to identify the nature of the costs that the different units are able to impose on others, Hayek seems to retort to the above mentioned unspecified criteria of "expediency": "The main practical difficulties arise from the fact that most measures of town planning will enhance the value of some individual properties and reduce that of others. If they are to be beneficial, the sum of the gains must exceed the sum of the losses" (Hayek, 1960: 304). Nevertheless, and as it has been emphasised by the

institutionalist tradition in economics, the definition of what is a benefit and what is a cost depends on a previous allocation of rights and cannot therefore be used to justify them (Samuels, 1992; Bromley, 2006).

This only serves to reinforce Bromley's point that "the bulk of what happens in externality policy concerns the necessary restructuring of institutional arrangements (property rights)". This process creates huge dilemmas for public policy because the way economic units perceive the costs and benefits of their actions is precisely dependent on a previous definition of "the rights-obligation structure" of the economy in a context where interdependencies are bound to be rife and conflicts will abound given the issues at stake (Chang, 2002). In the end, the way this problem will be approached, as Samuels (1992) clearly indicates, is very much dependent on the values and ideologies that are able to shape public policy. Although, he did not directly confronts these issues, Hayek shows a clearer awareness of the political and moral dilemmas they pose for his version of liberalism and for its preferred institutions, making the definition of clear lines between "the agenda and nonagenda of government" ever more elusive in a capitalist system.

4. The epistemic role of government

This section considers what might be called the "knowledge argument" in Hayek's agenda for government. By this at least two things are meant: on the one hand, Hayek's argument that there are certain forms of knowledge which might require the existence, and the sustenance by the state, of non-market institutional arrangements; on the other hand, the recognition that state authorities are sometimes in a better position to promote the dispersion through society of forms of knowledge which can advantageously be made accessible to all. These can also be used in the indispensable political regulation of markets.

One of Hayek's main contributions to political economy and to social theory in general is the exploration of the systemic implications of the fragmentary, dispersed and incomplete nature of human knowledge (Gamble, 2006). In fact, every socioeconomic system has to be assessed according to its capacity to use, to the maximum extent

possible, the “knowledge of circumstances”, which “never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess” (Hayek, 1948d: 77). Hayek’s epistemic critique of socialist proposals for planning, made within the so-called socialist calculation debate, is premised upon the idea that central authorities cannot expect to have access to, and make use of, all the knowledge which is dispersed through a myriad of economic actors. In particular, central authorities cannot expect to profit from the mutable knowledge of “particular circumstances of time and place” which, by its own nature, is only accessible to “the man on the spot” and which cannot, at least not in its entirety, be transmissible through the formalized procedures necessarily embodied in central planning (Hayek, 1948d: 80). The economic importance of this knowledge requires the existence of institutional arrangements which give ample room for economic actors to make decisions, as producers or as consumers, based on their own evaluations of the particular context they are facing and of the opportunities that it may offer to them. This simultaneously requires forms of decentralization and coordination which, according to Hayek, only the market, despite all its imperfections, is able to provide.

The market is then said to be an indispensable coordination device which creates the conditions, by generating pecuniary incentives, for economic actors to make the best use they can of the different forms of knowledge that each one of them possesses. Furthermore, and as result of the process of market competition, there tends to emerge a constellation of prices which synthesize and diffuse some of the knowledge that was previously dispersed and which also functions as a signaling and informational device that help economic actors by giving them a condensed overview of the economic landscape that they are facing. In this process, market prices not only help economic actors coordinating their individual plans, but also to revise them and even to forge new ones, thereby creating an adequate environment for the discovery of valuable new knowledge. Throughout Hayek’s work, as O’Neill (1998: 129) has synthesized, “the market is presented as a self-regulating economic homeostat, providing the informational feedback between economic actors necessary for the mutual adjustment of their activities”.

Nevertheless, this “economic homeostat” requires antecedent non-market institutional arrangements which, among other things, have to guarantee the existence of knowledge, most visibly of a technical and codifiable kind, which the market seems sometimes incapable of generating by itself. Since these forms of knowledge are helpful for economic actors in their market activities, they should also be made widely available. Hayek (1944) considers that the state, as part of its overall function of “planning for competition”, might have to assure the existence of “channels of information” available to all agents who happen to need access to them. Hayek (1960: 195) clarifies what might be involved here:

A great many of the activities which governments have universally undertaken in this field and which fall within the limits described are those which facilitate the acquisition of reliable knowledge about facts of general significance. The most important function of this kind is the provision of a reliable and efficient monetary system. Others scarcely less important are the setting of standards of weights and measures; the providing of information gathered from surveying, land registration, statistics, etc.; and the support, if not also the organization, of some kind of education.

This means, as Greenwood (2007: 428) has recently emphasized, that “Hayek does not entirely reject the possibility of centralized institutions having access to economically relevant knowledge”. Since Hayek considers that the market might not be entirely conducive to the emergence of some forms of “reliable knowledge”, although it badly needs them for its proper functioning, the state should step in, supporting institutions whose main function is precisely to assure that it is made available. The question is thereby one of recognizing the epistemic virtues of markets and of the constellation of prices that are generated in them, while retaining the idea that markets, and the patterns of interaction they foster, are not enough in terms of assuring the diversity of knowledge that society needs. Finding the best articulation between a diverse set of institutional arrangements is the challenge to be met. Although, as always in Hayek, this articulation is asymmetric since non-market institutional arrangements should be geared and subordinated to the need of assuring that individuals possess the best context possible to be able to make their market decisions. This becomes very clear when, in discussing the exploitation of natural resources, Hayek (1960: 321) claims that:

It cannot be denied that there are some facts concerning probable developments which the government is more likely to know than most of the individual owners of natural resources. Many of the recent achievements of science illustrate this (...) We can bring together all the knowledge that is relevant to particular problems only by dispersing downward the generic knowledge available to government, not by centralizing all the special knowledge possessed by individuals.

This formulation complements Hayek's (1948d) "knowledge argument" against socialist planning. It retains the idea that the function of government is not to substitute itself to the decisions made by the "man on the spot", whoever he or she might be, but instead to make available knowledge that might be of value. This also helps to clarify not only the position of the state in this area, but also the forms of knowledge in which it might have a comparative advantage: expert knowledge, based on scientific investigation, with higher chances of being codifiable and thereby easily transmitted throughout society. Besides dispersing this sort of knowledge, presumably through non-market means, the state can, in certain circumstances, make good use of it to regulate markets, i.e. to shape the rights and obligations of the different parts of an economic interaction.

The need to avoid "arbitrary discrimination between persons", said to be present for example in all efforts to directly influence prices or supply, explains Hayek's (1960: 199) reluctant acceptance of state-sponsored regulation of markets. This reluctance can also be seen by Hayek's claims that this should be constrained by a cost-benefit exercise presumably done by government. This reinforces the idea that the state must have access to impartial expert knowledge not only about the workings of the sectors to be regulated, but also about the likely net effects of the particular measures being discussed. Hayek (1979: 62) gives a few examples of the type of regulations that it might be "expedient" for the state to enforce:

Building regulations, pure food laws, the certification of certain professions, the restrictions on the sale of certain dangerous goods (such as arms, explosives, poisons and drugs), as well as some safety and health regulations for the processes of production and the provision of such public institutions as theatres, sport grounds, etc., certainly assists intelligent choice and sometimes might be indispensable for it. That the goods offered for human consumption satisfy certain minimum standards of hygiene, as for example that pork is not trichinuous or milk not tuberculous, or that somebody who describes himself by a term generally understood to imply a certain competence,

such as a physician, really possesses that competence, will be most effectively assured by some general rules applying to all who supply such goods and services.

This list, which has the advantage of systematizing a set of regulations recognised as potentially necessary for the functioning of markets at least since *The Road to Serfdom* and further discussed at length in the *Constitution of Liberty*, also reveals the degree of technical competence and expertise that might be needed to assure a proper functioning of markets. It also shows that, in Hayek's view, markets might not automatically create the right conditions for knowledge about goods and services to be available to all who might need it, specially to consumers who seem to be particularly vulnerable in this regard. By regulating markets, through the enforcement of rules and standards, the state assures the community that the goods and services being provided have certain characteristics. Most of the times this can only be ascertained by having access to the requisite expert knowledge. Giving the reality of the division of knowledge in society, most people cannot expect to possess this knowledge about the variety of goods and services that might be accessible to them. Thereby, behind Hayek's (1948d: 86) famous contention that the "most significant fact about this system [the constellation of prices, permanently being generated in markets] is the economy of knowledge with which it operates, or how little individual participants need to know in order to be able to take the right action", lies a set of state-enforced rules which contribute to assure this by other means. Otherwise, how could Hayek claim that with the right type of regulations in place "the choice of consumer will be greatly facilitated" (Hayek, 1979: 62)? This squares well with Fleetwood contention: "Hayek argues that the discovery, communication and storage of knowledge is facilitated not by the telecom system *alone* but by the telecom system articulating with, and embedded within, a dense web of social rules of conduct". As shown above, at least some of these rules, and the knowledge they embody, have to be deliberately imposed by the state. And this process, as Hayek (1960: 197) acknowledges, has an impact upon the structure of the costs that corporations have to face and presumably on prices. This only means, as institutional economists have emphasized, that the rules that structure markets help to determine who is more likely to bear the costs of economic activity, regardless of these being mediated by prices or not (Bromley, 2006).

The articulation between expert knowledge and certain types of social rules allow us to point to some specific institutional arrangements which might be conducive to their emergence and diffusion. This is particularly important as far as scientific knowledge is concerned. Again Hayek considers that the aim of furthering the “dispersion and increase in knowledge throughout the community at large” requires some sort of state assistance. This is so because “the benefits that a community receives from its scientists and scholars cannot be measured by the price at which these men can sell particular services, since much of their contribution becomes freely available to all” (Hayek, 1960: 331)¹⁴. Hayek thereby seems to rely, to an unspecified extent, on other institutional mechanisms to assure its emergence. This is not only a matter of expecting the state to step in to correct a “market failure”, by assuring that public financing is available to sustain scientific research, but also a matter of acknowledging that the “advance of knowledge” requires “academic freedom” which presupposes the existence of institutions organized in a particular way (Hayek, 1960: 336). Appropriate conditions must then be created. Indeed for Hayek (1960: 338):

There should be as many independent centers of work as possible, in which at least those men who have proved their capacity to advance knowledge and their devotion to their task can themselves determine the problems on which they are to spend their energies and where they can expound the conclusions they have reached, whether or not these conclusions are palatable to their employer or to the public at large. In practice, this means that those men who have already proved themselves in the eyes of their peers, and who, for this reason, have been given senior positions in which they can determine both their own work and that of their juniors, should be given security of tenure.

Scientific knowledge can then only flourish in an environment where researchers have the capacity to conduct their own work with a certain degree of autonomy. This is achieved, on the one hand, by processes of partial detachment from market pressures or from the hierarchical and command structure of the capitalist firm geared towards profit-making, and, on other hand, by assuring that the coercive apparatus of the state does not impose some blueprint to guide the research efforts to some politically

¹⁴ It is worth noting that Hayek (1948b: 114), in the context of a discussion of what “the precise rights are to be which the government ought to protect”, manifests his skepticism about the advantages of the extension of property rights to knowledge, through the adoption of patents, as a way to create the incentives for the promotion of scientific knowledge.

preconceived end. Strangely, even while seemingly aware of the dangers of both these processes for what might be called, following Macintyre (1985), the “internal goods” of the scientific practice, Hayek (1960: 339) seems to take for granted the existence of the conditions that would allow them to be successfully blocked: “The need for protecting institutions of learning against the cruder kind of interference by political or economic interests is so well recognized today that there is not much danger of its being successfully exercised in reputable institutions”.

Hayek’s “agenda of government” in the area of the diffusion of knowledge also includes the plea for the state to enforce “compulsory education up to a certain minimum”, although he does not clearly specify what that minimum should be, and to guarantee that everyone has access to it (Hayek, 1960: 325). This implies a “deliberate effort” to surmount some of the obstacles that may prevent individuals to have access to certain forms of knowledge but also, and perhaps more importantly, to create the conditions that enable them to develop skills and capacities that will partially determine their subsequent degree of autonomy, or, as Hayek (1960: 325), the degree to which they will “judge well for themselves what will be useful to them”. In the context of this discussion, Hayek not only recognizes that a market society can only function if individuals share some “standard of values”, which supposedly can be taught and learned, but also that their position in the division of labour and their capacity to profit from, and to contribute to, the forms of knowledge that it involves will be somewhat shaped by what they have previously learned. Once again the need to articulate market and non-market structures is clear in this regard. As it is clear in the agenda that Hayek proposes for the organisation of the school system. Hayek (1960) fully endorses Friedman’s (1955) famous and controversial plan to institute a state-financed voucher system that tries to combine the public financing of education with its private provision. The proclaimed objective is to retain the advantages of competition and decentralization without the creation of barriers, through the price system, that would exclude individuals from the compulsory education that the community has the advantage to guarantee to all its members. This is not only squarely in line, as it shall be argued in the next section, with Hayek’s vision of what he labeled the “service state”, but also reveals some of the principles that might support its deliberate organization.

6. The ‘service state’ or the political sustenance of a market society

Hayek was a critic not only of socialist proposals for central planning, but also of social democratic efforts of “muddling through” by introducing reforms in the fundamental institutions of capitalism. While recognising the unavoidability of markets, social democracy would still have the counterproductive aim of assuring a distribution of resources based on criteria of social justice which would be incompatible with a market society. It has been claimed, among others by Gray (1989: 131), that “the ground of Hayek’s arguments shifts and becomes less clear” as his criticisms move from central planning to the political practices he associated with the “muddle of the middle” typical of western post-war governments, particularly in the areas associated with the welfare state. Burczak (2006) argues that this is partially because Hayek accepts the need for a social-safety net, but does not give clear reasons that might ground its existence nor the correspondent obligation of governments to provide it. This seems another instance of what Block (1996) refers as Hayek’s unprincipled compromises with “state interventionism”.

In the context of the redefinition of the liberal agenda of government, Hayek accepts the need for some form of state-sponsored support to individuals. There is then an effort to put forward some general principles that might help to assure that its more or less unavoidable growth would be “entirely compatible with the functional requirements of a market system” (Kley, 1994: 86). In this, as in all other areas that are part of the agenda of government, Hayek argues that “it is the character rather than the volume of government activity that is important”.

He offers a careful formulation of the problem at hand: “we cannot argue (...) against the welfare state, for this system does not designate a definite system”. This so because “what goes under that name is a conglomerate of so many diverse and even contradictory elements that, while some of them may make a free society more attractive, others are incompatible with it or may at least constitute potential threats to its existence” (Hayek, 1960: 226). Once again, lines have to be drawn here.

The concept of the “service state” encapsulates, or so we argue, Hayek’s efforts to devise a viable alternative to some facets of the welfare state that he found wanting, while retaining others, the main aim of which would be, according to Kley (1994: 86), to check some of the threats to the political legitimacy of markets seemingly caused, among other things, by their own failures. These could lead, for example, to the existence of forms of intense and avoidable deprivation among a section of the population. “Public assistance” might be framed as a “duty of the community”, but could also be thought, perhaps more appropriately for Hayek, as a way to protect society “from the acts of desperation on the part of the needy” (Hayek, 1960: 248). This, of course, amounts to a recognition that the market might be incapable of automatically guaranteeing the minimum conditions for all individuals’ sustenance. Nevertheless, he was always confident that its wealth-generating prowess could make it easy and politically non-contentious to publicly finance a “service state” designed to assure, among other things, the security of a growing “minimum income” (Hayek, 1944: 124).

Hayek presents the role of government in this area as the continuation, albeit by other means, of the decentralized initiatives, the charitable efforts and the solidarities forged in more communitarian environments, through which, or so he argues, the problems of poverty and of extreme need have always been tackled (Hayek, 1960: 248). Hayek (1960) then argues that the principles which have underlined previous, and apparently successful, efforts at guaranteeing a “minimum sustenance” to all in need can be replicated by forms of public assistance exclusively channeled to those who fall below an unspecified, and seemingly historically contingent, minimum threshold. The concept of human need appears in the discussion at this stage. For example, Hayek (1960: 249) speaks of “the extreme needs of old age, unemployment, sickness” as issues requiring some form of government involvement, but without giving any indication about the standards through which these needs might be politically ascertained or recognized. He also takes for granted that the existence of a social-safety to be provided “outside the market” would not have major implications for the relative position and decisions of individuals in markets and, in particular, for their degree of autonomy, for example, as labourers. Nevertheless, it is clear that the establishment of a guarantee that some, even if unspecified, “minimum of food, shelter and clothing, sufficient to preserve health and the capacity to work, can be assured to everybody” has an impact on individuals’

capacity to structure the terms of market exchanges and indirectly on the resources they are able to command as result of that (Hayek, 1944: 124). This seems yet another example showing the problematic nature of Hayek's (1944) contention that the state should not interfere with markets so that prices are kept "intact" in their sphere. In reality, by being involved in the definition and redefinition of the contexts where markets operate, the state has always an impact, even if an indirect one, on the constellation of markets prices that will eventually emerge.

As it was alluded before, Hayek's real priority in these areas was actually to define the character and the nature of the service state in order to establish the guidelines to what seemed the inevitable expansion of its size, seemingly as the by-product of the realities of social order in an "industrial society" (Hayek, 1960: 248). Here Hayek tries to balance the recognition that there obvious advantages to be had by using the coercive apparatus of the state to somehow regulate and guarantee the organization and development of certain services in areas such as social insurance and public assistance to those who are eligible for it, with the liberal principles through which he tries to draw a principled line between the agenda and non-agenda of the service state: "Though government must not use its power of coercion to reserve for itself activities which have nothing to do with the enforcement of the general rules of law, there is no violation of principle in its engaging in all sorts of activities on the same term as the citizens" (Hayek, 1960: 196). This simply means that the government should avoid establishing itself as the sole provider of the services by instituting monopolies and compelling people to use them. Nor should the government give an undue advantage to it agencies by entirely financing their functioning, by subsidizing their operations or by giving them other special conditions which are not available, on exactly the same terms, for the private initiatives that may eventually emerge and be capable of meeting the same general conditions that the state defines for the provision of the services concerned.

The state can then guide, nurture and accelerate the development of certain services and of new institutional arrangements through which they are provided: "there is little reason why the government should not also play some role, or even take the initiative, in such areas as social insurance and education, or temporarily subsidize certain experimental developments" (Hayek, 1960: 225). The government can even use its

powers to compel individuals to use certain services. This is the case of “social insurance”. It is very interesting that Hayek sees this obligation as the result of the free-rider problems emerging from the existence of a social-safety net that guarantees to all, regardless of their contribution, a certain minimum for their sustenance when certain conditions are met. Compulsory insurance is a way to minimize the perverse incentives that might then be created (Hayek, 1960). Here Hayek is rehearsing the famous slippery-slope argument, formulated in the *Road to Serfdom*, according to which a dynamic of state interventions is ensued by interfering with preexistent market arrangements, while at the same time recognizing that if the state intervenes according to his own advises, this dynamic can actually lead to the virtuous emergence and development of new markets (Ikeda, 1997). In the area of welfare services this should clearly be the state’s overarching goal. Hayek is thereby confident that through intelligent public policies it is possible to create markets for welfare services while at the same time guarantee, for example through subsidies, that everyone has access to them. This is part and parcel of Hayek’s effort to create the conditions for market competition to emerge in certain areas of social life: “the manner in which the government provides such services should not be such that it makes it impossible for others to provide them” because “new methods may be found for making a service saleable (...) and thus make the market method applicable to areas where before it could not be applied” (Hayek, 1979: 47).

The existence of competition between providers, the possibility of choice, the establishment, as far as possible, of a close relation between what is paid and what is provided and of a clear separation between this and public assistance to those in need are, for Hayek (1960), the best ways to create or to replicate the virtues that he attributes, if properly supported by the state, to markets: the capacity to allow for experimentation, the creation of pecuniary incentives for the discovery and diffusion of knowledge about new, and eventually, better methods of provision or the possibility, given to “consumers”, of choosing among a variety of providers of welfare services. The service state is then opposed by Hayek to what he calls “the household state”, i.e. the welfare state as a “coercive monopolist” of social services financed by progressive taxation which aimed at achieving an a preconceived pattern of resource allocation based on some unspecified and untenable notion of social justice (Hayek, 1960:).

On the contrary, Hayek's (1960) service state might be understood as the embodiment of the liberal "gardener" which aimed at creating and recreating the right context for markets, with varied degrees of specificity, to emerge (Hayek, 1944). Furthermore, the internal workings of the apparatus of the service state should themselves be molded at the image of the market. This is arguably dimension where Hayek anticipates and perhaps inspires some of the principles that would later guide what Marquand (2004) labels the deliberate process of "market mimicry" in the organization of state institutions. Indeed, Hayek (1960: 230) was convinced that it was possible, through a process of deliberate decentralization, to organize state activities so as to create an environment of desirable market competition between them:

There are strong reasons why action by local authorities generally offers the next-best solution where private initiative cannot be relied upon to provide certain services and where some sort of collective action is therefore needed; for it has many of the advantages of private enterprise and fewer of the dangers of the coercive action of government. Competition between local authorities or between larger units within an area where there is freedom of movement provides in a large measure that opportunity for experimentation with alternative methods which will secure most of the advantage of free growth.

7. Final remarks

This article has tried to explore the claim that there is an ample and ineradicable agenda of government in Hayek's reconstruction of the principles of liberalism which simultaneously reveals his view on the main limitations of markets. These limitations can be understood in two complimentary ways. On the one hand, markets require antecedent political preconditions which they necessarily fail to provide. On the other hand, markets cannot or should not expand to all areas of human life which are crucial to social order. And even if, and when, it is desirable that they expand to some of them, this is sometimes not possible without direct political guidance and support.

In a sense, Hayek acknowledges the validity of Polanyi's (1944) central claim that social life cannot be organized by exclusively relying on the idea of the self-regulating market. His account of the traits of the market society thereby accommodates a certain degree of institutional impurity. This has not been fully taken into account by some of

his critics. For example, when Hodgson (1999) claims that Hayek's intransigent defence of the market does not leave any room for the fact that no viable socioeconomic system can exist without relying on a plurality of patterns of interaction generated by different institutional arrangements, market and non-market, he seems to underestimate the extent of Hayek's agenda of government. Even the epistemic defence of markets, which is considered one of the most solid arguments developed by Hayek, when discussed in the context of the agenda of government, allows us to see the need that he has to argue for an articulation of a variety of institutional arrangements which are needed to generate different forms of knowledge. Although, as always in Hayek, this articulation seems to be asymmetric since non-market institutional arrangements should be geared and subordinated to the need of assuring that individuals possess the best context possible to be able to make their market decisions. But asymmetry is not the same as appealing to a purified economic system. It is also true that this agenda can be conceived as a good example of what Leys (2001) has recently called the phenomenon of "market driven politics", in the sense that it is ideally directed towards the creation of markets in almost all areas of social life. But again this overarching goal is tempered by a recognition, albeit a reluctant and under-theorized one, that there will always be goods which have to be provided and/or made somehow accessible to some groups according to non-market principles or according to market principles tempered by particular forms of public regulation and support.

Important tensions and difficulties in Hayek's political economy are thereby created by the sources of unavoidable impurity that have been identified in this article. The idea of planning for competition reveals that there are clear institutionalist elements in Hayek's view of the market. Indeed, from his inquiry into the political preconditions of the market there tends to emerge a view according to which this institution can be structured in different ways, partially as the result of decisions made in the political realm, broadly understood, which will influence the patterns of interaction and the results that individuals, in different social positions, will thereby obtain. Furthermore, regulation, the definition of property rights or the scope of contracts are repeatedly referred as challenges to the liberal agenda in this regard, but they are never thoroughly confronted perhaps because doing so would reveal the eminently contested and political nature of markets. These ideas also do not square well with Hayek's insistence on the

neutrality of both the rule of law and the ideal liberal government bounded by it and guided in many of its activities by a seemingly vague, apolitical and ultimately untenable idea of expediency. We have argued that expediency, even if it could be made operational within Hayek's subjectivist framework, does not suffice to deal with the moral and political dilemmas that arise in the provision of public goods, in the management of externalities or in the organization of the service state. All these issues, as Samuels (1989: 428) has argued, are finally not "a matter of having the government intervene into a process in which it hitherto had been absent but of (re)determining the interests to which government will lend its support".

The discussion of the agenda of government is also difficult to articulate with a position, also present throughout Hayek's work, which tends to portray institutions as the product of spontaneous and unguided processes of evolution or to argue that the use of reason can only have a very limited role in shaping social order. It is not by chance that when discussing the role of government, there emerges what Shearmur (2006: 164) labels "Hayekian social engineering", i.e. the recognition that any market society may indeed demand a constant deliberate political effort to guarantee that its fundamental institutional arrangements are "intelligently designed and continuously adjusted" (Hayek, 1944: 49).

The problematic nature of drawing clear lines between the agenda and non-agenda of government or the impossibility of creating an indisputable compass that might orient how they are drawn then become clear. Keynes's challenge to Hayek's version of liberalism remains partially unanswered. But perhaps this challenge can never be met in its entirety given the dynamics at work in every capitalist system. Indeed, when discussing Hayek's political economy, Gamble (1985: 370) has perceptively argued that:

There is a double process at work in capitalism; constant pressure to expand markets and commodity production, hence ever greater individualisation of needs and penetration of capital into new areas; but at the same time constant pressure for non-market agencies to support and sustain the process of capital accumulation by carrying the political, ideological, administrative, as well as ideological 'deficits' it constantly generates.

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