



## HAYEK, LAW, AND COGNITION

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Friedrich Hayek studied law as well as economics in college<sup>1</sup>—in fact his first university degree was in law<sup>2</sup>—and in the latter part of his long career he wrote extensively about law, including the trilogy entitled *Law, Legislation and Liberty*. My goal in this paper is to describe and evaluate his theory of law and relate it to his theory of cognition, which provides the basis of his entwined legal and economic theories.

### I.

Hayek is famous for two ideas. The first, which builds on the work of the earlier Austrian economist Ludwig von Mises, is that socialism (in the sense of public ownership of the means of production) is unworkable because it requires more information about the economy than could possibly be obtained and processed by a central planning board.<sup>3</sup> The information necessary for the operation of the economy is dispersed among the multitude of individuals who engage in economic activity. Each has a tiny amount of the relevant information and the price system is the only feasible way in which the information possessed by each can be pooled and translated into an efficient schedule of economic outputs. (A current example of decentralized pooling of information is the World Wide Web, with its literally

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<sup>1</sup> FRIEDRICH A. HAYEK, HAYEK ON HAYEK: AN AUTOBIOGRAPHICAL DIALOGUE 62–63 (Stephen Kresge & Leif Wenar eds., 1994).

<sup>2</sup> ALAN EBENSTEIN, FRIEDRICH HAYEK: A BIOGRAPHY 28 (2001).

<sup>3</sup> See, e.g., Friedrich A. Hayek, *Economics and Knowledge*, 4 *ECONOMICA* 33 (1937); Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 *AM. ECON. REV.* 519 (1945); Friedrich A. Hayek, *Two Pages of Fiction: The Impossibility of Socialist Calculation*, in *THE ESSENCE OF HAYEK* 53 (Chiaki Nishiyama & Kurt R. Leube eds., 1984); Sherwin Rosen, *Austrian and Neoclassical Economics: Any Gains from Trade?*, 11 *J. ECON. PERSP.* 139 (1997); Steven Horwitz, *From Smith to Menger to Hayek: Liberalism in the Spontaneous-Order Tradition*, 6 *INDEP. REV.* 81 (2001); Louis Makowski & Joseph M. Ostroy, *Perfect Competition and the Creativity of the Market*, 39 *J. ECON. LITERATURE* 479, 487–89 (2001).

millions of “bloggers” whose uncoordinated but rapid and far-reaching pooling of information has made the “blogosphere” a formidable rival to the organized corporate news media.)

First advanced in the 1930s, when most economists considered socialism eminently feasible, and many considered it superior to capitalism, which had seemed in that depression decade to have proved itself incapable of organizing economic activity efficiently, Hayek’s idea<sup>4</sup> was prescient. His second famous idea, advanced in *The Road to Serfdom* (1944), was that socialism, even in the limited form advocated by the British Labour Party of the day, would if adopted lead inexorably to totalitarianism.<sup>5</sup> This idea has proved to be false. Socialism in either the limited form advocated by social-democratic parties or the extreme form instituted in the communist countries leads, via Hayek’s first point—the unworkability of socialism—to capitalism. The Soviet Union was totalitarian, but not because it was socialist. Nazi Germany was totalitarian but, contrary to Hayek and despite the name of Hitler’s party (National Socialist German Workers’ Party), it was not socialist. Nor was Hayek correct that socialist thought had paved the way for the Nazis by assisting in the creation of a planned economy for Germany during World War I,<sup>6</sup> though that planned economy did give Lenin ideas for organizing a communist economy in Russia.<sup>7</sup>

I have mentioned Hayek’s two famous ideas because of their influence on his legal theory.<sup>8</sup> The theory can be summarized as follows.<sup>9</sup> There are two ways of establishing norms to guide human behavior. In one, which Hayek calls “constructivist rationalism,”<sup>10</sup> they are prescribed from the top down by a legislature, a bureaucracy, or a judiciary—in other words by experts who gather the information necessary to formulate by the method of reason the best possible set of norms. This approach, as we might guess from Hayek’s aversion to central planning, he rejects

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<sup>4</sup> Later elaborated in a technical literature well illustrated by Sanford J. Grossman, *An Introduction to the Theory of Rational Expectations Under Asymmetric Information*, 48 REV. ECON. STUD. 541 (1981).

<sup>5</sup> FRIEDRICH A. HAYEK, *THE ROAD TO SERFDOM* 199–220 (1996 reprint ed.) (1944). In fairness to Hayek, the program advocated by the Labour Party was more radical than the one it implemented when it took power in 1945. But as late as 1972, in a foreword to a reprinted edition of the book, he reaffirmed its main conclusions.

<sup>6</sup> See *id.* at 183–98. The book has little to say about communism because, as Hayek later acknowledged, he had been reluctant to criticize the Soviet Union, Britain’s wartime ally. HAYEK, *Preface to the 1976 Edition*, in *THE ROAD TO SERFDOM*, at xxiv.

<sup>7</sup> See, e.g., 2 EDWARD HALLETT CARR, *A HISTORY OF SOVIET RUSSIA: THE BOLSHEVIK REVOLUTION 1917–1923*, at 363 (1952); G.D.H. Cole, *The Bolshevik Revolution*, 4 SOVIET STUD. 139, 150 (1952).

<sup>8</sup> The theory itself is lucidly summarized in CHARLES COVELL, *THE DEFENCE OF NATURAL LAW* 126–39 (1992).

<sup>9</sup> Hayek’s *Law, Legislation and Liberty* contains the fullest statement of his legal theory. See 2 FRIEDRICH A. HAYEK, *LAW, LEGISLATION AND LIBERTY: A NEW STATEMENT OF THE LIBERAL PRINCIPLES OF JUSTICE AND POLITICAL ECONOMY: RULES AND ORDER* (1973) [hereinafter HAYEK, *RULES AND ORDER*] (expounding and defending Hayek’s legal theory). But he discusses law at almost the same length in the second part of his earlier book, *The Constitution of Liberty*. See FRIEDRICH A. HAYEK, *THE CONSTITUTION OF LIBERTY* (1960). A very similar theory of law is propounded in BRUNO LEONI, *FREEDOM AND THE LAW* (3d ed. 1991). Leoni, an Italian lawyer who was a friend of Hayek, published the first edition of his book in 1961, the year after *The Constitution of Liberty* was published.

<sup>10</sup> See, e.g., HAYEK, *RULES AND ORDER*, *supra* note 9, at 95, 117.

as requiring too much information. In addition, it endangers liberty by enlarging the administrative powers of government and thus weakening the rule of law – the thesis of *The Road to Serfdom*.<sup>11</sup>

The alternative method of creating norms is that of custom and has the superior virtue of being what Hayek calls a “spontaneous order,” as distinct from one brought about by plan or design. The word “spontaneous,” with its connotation of suddenness, is not the happiest term for what he had in mind; “unplanned” or “undisigned” would be better and “evolved” would be best, given the analogy of natural selection. The natural world is an extraordinarily complex system, amazingly “well designed,” but according to Darwinian theory there was no designer. Markets are another example of “spontaneous order” in Hayek’s sense. They emerged thousands of years ago; they were not invented or designed; and their operation does not involve central planning. Consider the system by which New York City is supplied with a perishable commodity such as milk. No milk czar decides how much milk is needed when and by whom and then obtains the necessary inputs, which include dairy farms and farmers, milk-supply plants, refrigerated milk trucks, packaging equipment and materials, accounting and other support activities, and the scheduling and provision of delivery to retail outlets. And yet the interactions of millions of consumers and tens of thousands of input suppliers result in an orderly supply. There is no coordinator—except price. A still larger spontaneous order, moreover, coordinates the New York milk market with other regional and product markets and ultimately with the entire national and world economy.

In the normative realm the spontaneous order that corresponds to the market is custom; indeed the market itself could be thought a product of custom. So strong is Hayek’s aversion to planning that at times he comes close to denying that legislatures have *any* business legislating in the sense of regulating private behavior. Regulation in his view is the task of custom. Hayek is not an anarchist. He does not want to abolish government. But he thinks that virtually the only proper business of a legislature is to direct and control the government, for example by levying the taxes that are necessary to defray the cost of government and by appointing and monitoring government officials.<sup>12</sup> He points out that historically that *was* the primary function of the British Parliament and not the laying down of rules of conduct for private citizens. Most of those rules were laid down by the royal judges. Those are the rules and doctrines of the common law. Even crimes were declared and defined by judges. (The modern view, at least in the U.S. federal system, is that there are no common law crimes; declaring conduct criminal is a legislative prerogative.) But judges’ traditional aversion to appearing to be creative led them to say that what they were doing in deciding common law cases was not mak-

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<sup>11</sup> “A directed economy must be run on more or less dictatorial lines . . . Whoever controls all economic activity controls the means for all our ends and must therefore decide which are to be satisfied and which not.” HAYEK, *THE ROAD TO SERFDOM*, *supra* note 5, at 97, 101.

<sup>12</sup> HAYEK, *RULES AND ORDER*, *supra* note 9, at 125–31. Elsewhere, however, as we shall see, he allows a significantly greater scope to legislation.

ing new rules or standards of conduct but merely enforcing immemorial custom. Hayek took this claim literally. He thought (and he believed that the English common law judges thought) that the only question a judge is entitled to decide is “whether the conduct under dispute conformed to recognized rules,” that is, to “the established custom which they [the parties] ought to have known.”<sup>13</sup> Alternatively but equivalently, the judges’ duty is to enforce the expectations created by custom.<sup>14</sup> Judges who step outside this boundary are—and here we see the influence of Hayek’s second master idea at work—stepping onto the slippery slope to totalitarianism: “a socialist judge would really be a contradiction in terms.”<sup>15</sup>

But so, by Hayek’s logic, would a capitalist judge be. The contradiction Hayek identifies has nothing to do with the content of the judge’s policy views. It lies rather in the judge’s allowing those views to influence his decisions. Hayek acknowledges that there are gaps in legal rules and, what amounts to the same thing, that “new situations in which the established rules are not adequate will constantly arise,” requiring the “formulation of new rules” by the judges.<sup>16</sup> But they are to fill these gaps with custom. Their role remains a passive one. They are prohibited from engaging in a “balancing of the particular interests affected [by the rules] in the light of their importance” or from concerning themselves “with the effects of [the rules’] applications in particular instances.”<sup>17</sup> In fact, “neither the judges nor the parties involved need to know anything about the nature of the resulting overall order, or about any ‘interest of society’ which they serve.”<sup>18</sup> The “overall order” which the judges are to serve is the market,<sup>19</sup> but they needn’t even know that. The Hayekian judge “is required to think only about the internal logic of the law.”<sup>20</sup>

Hayek does not think that *all* customs should be made enforceable by legal sanctions—only those that are general or, the term he prefers, “abstract.”<sup>21</sup> Contract law is the paradigm. It provides merely a framework for private action, leaving the identity of the parties, and the price and other terms of the contract, to private determination. That is, contract law abstracts from all the particulars of people’s voluntary interactions and so maximizes their freedom, their “spontaneity.”

Hayek does not explain who decides which customs shall have the backing of law. But presumably it is the judges, whom he would also permit to engage in “piecemeal tinkering . . . to make the whole [body of law] more consistent both internally as well as with the facts to which the rules are applied.”<sup>22</sup> The scope of this

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<sup>13</sup> *Id.* at 87. Like his fellow-Austrian conservative Joseph Schumpeter, Hayek greatly admired the British political system—and in both cases the *limitations* on democracy were the aspect of the British system that particularly attracted them.

<sup>14</sup> *Id.* at 97, 119.

<sup>15</sup> *Id.* at 121.

<sup>16</sup> *Id.* at 119.

<sup>17</sup> *Id.* at 121.

<sup>18</sup> *Id.* at 119.

<sup>19</sup> *Id.* at 115.

<sup>20</sup> Ludwig Van den Hauwe, *Friedrich August von Hayek (1899–1992)*, in *THE ELGAR COMPANION TO LAW AND ECONOMICS* 339, 344 (Jürgen G. Backhaus ed., 1999).

<sup>21</sup> See, e.g., HAYEK, *THE CONSTITUTION OF LIBERTY*, *supra* note 9, at 151–54.

<sup>22</sup> HAYEK, *RULES AND ORDER*, *supra* note 9, at 118.

dispensation is unclear, however, and may be quite narrow, for a few pages farther on Hayek says that “impartial justice . . . is not concerned with the effects of their application [that is, the application of ‘end-independent rules’].”<sup>23</sup> And “the judge is not performing his function if he disappoints reasonable expectations created by earlier decisions.”<sup>24</sup> Hayek’s disapproval of law founded on “constructivist rationalism” rather than on custom is in considerable tension with his great admiration for the Constitution of the United States.<sup>25</sup>

When Hayek is writing against lawgiving by legislatures and judges, any perception of the existence of externalities or of other sources of market failure is occluded. Yet he is aware that the amount of pollution is not optimized, or cartels prevented from arising, by the spontaneous order of the market. The control of pollution and of monopoly requires government to intervene in the market.<sup>26</sup> Hayek thinks the scope of public intervention should be quite limited, but he acknowledges its necessity. He is not a doctrinaire adherent to the idea that the only proper functions of government are internal and external security, the functions of the “night watchman” state. *The Constitution of Liberty* countenances some surprising departures from laissez-faire,<sup>27</sup> though Hayek is skeptical that economists have much to contribute to the design of public regulation of the economy.<sup>28</sup>

But he is insufficiently critical of the limitations of custom as a normative order.<sup>29</sup> He puts too much weight on evolution, neglecting the fact that, lacking a teleology, evolution cannot be assumed to lead to normatively attractive results. Two limitations of custom as a source of social norms require particular emphasis. The first arises from the fact that, as in the pollution and monopoly examples, customs often support cooperative activities that are harmful to society as a whole. Competing firms might evolve a custom that price cutting is unethical; that custom, encouraging an unwholesome degree of cooperation, obviously could not be made the basis of antitrust law—in fact it has to be forbidden by that law. Similarly, manufacturers could be expected to evolve a custom of ignoring the pollution they create; that custom could not be made the basis of environmental law. Or consider, what is analytically similar, accidents to “strangers” in the sense of persons with whom the injurer has no actual or potential contractual relation. The customary level of safety in the injurers’ industry could not be assumed to be socially optimal, because, unless they were forced to do so by law or were improbably altruistic, the injurers would not take into account the accident costs of their victims in deciding

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<sup>23</sup> *Id.* at 121.

<sup>24</sup> *Id.* at 88; see COVELL, *supra* note 8, at 133.

<sup>25</sup> See HAYEK, *THE CONSTITUTION OF LIBERTY*, *supra* note 9, at 177–78.

<sup>26</sup> See, e.g., 3 FRIEDRICH A. HAYEK, *LAW, LEGISLATION AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE* 42–43, 86–87 (1979); EBENSTEIN, *supra* note 2, at 225.

<sup>27</sup> HAYEK, *THE CONSTITUTION OF LIBERTY*, *supra* note 9, at 224–31.

<sup>28</sup> *Id.* at 229–30.

<sup>29</sup> These are emphasized in Francesco Parisi, *Spontaneous Emergence of Law: Customary Law*, in 5 *ENCYCLOPEDIA OF LAW AND ECONOMICS: THE ECONOMICS OF CRIME AND LITIGATION* 603, 611–18 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000), and in Richard A. Posner & Eric B. Rasmusen, *Creating and Enforcing Norms, with Special Reference to Sanctions*, 19 *INT’L J. L. & ECON.* 369 (1999).

how safely to conduct their activity. Courts therefore refuse to make compliance with industry custom a defense to liability for negligence—an example of an economically sound judge-made rule of law that is not based on custom.<sup>30</sup> The rejection of custom as a defense to liability in such cases is consistent with Hayek's conception of economic efficiency, but it is inconsistent with the role he assigns to judges. They are not to upset customs.

Second, Hayek ignores the problems that arise from the fact that custom, being acephalous (there is no "custom-giver" analogous to a legislature, which is a lawgiver), tends to change very slowly. If economic or other social practices are changing rapidly, custom will often fail to keep up and will become a drag on progress. There are many dysfunctional customs; failure to recognize this fact is a parody of Burkean conservatism. Hayek rejected the label of conservative for himself, but it is unclear how his veneration of custom can be squared with that rejection.

Limiting judicial discretion as tightly as Hayek wanted to do might be defended by arguing that legislatures have superior competence to judges when it comes to prescribing rules of conduct. But the closest Hayek comes to making such an argument (which would have required him to acknowledge forthrightly the limitations of custom as a source of law, something he was unwilling to do) is in emphasizing that rules should be changed only prospectively, which is the method of legislation, in order to protect reasonable expectations.<sup>31</sup> This cannot be a complete theory of the respective competencies of legislatures and courts, especially since Hayek is so distrustful of legislatures.

Valid or not, Hayek's position that the only thing a judge should do is enforce custom without regard to consequences (because it is the only legitimate source of law, and therefore a legal judgment that does not draw its essence from custom is not true law)<sup>32</sup> extinguishes any role for economic or other social-scientific analysis in adjudication. Paradoxically, economist Hayek closes the space that economic analysis might occupy in adjudication.

It might be argued that he doesn't reject economic analysis of law but merely rejects an economic analysis that says that judges should use economics to help decide their cases. If Hayek based this rejection on economic grounds, it would mean that he was simply offering a rival economic theory of law to the standard one.<sup>33</sup> And to an extent he does base rejection of using economic analysis to

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<sup>30</sup> See WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF TORT LAW* 131-39 (1987). It is unsound, however, when applied to accidents arising out of a contractual relation between injurer and victim. See *id.*

<sup>31</sup> HAYEK, *RULES AND ORDER*, *supra* note 9, at 88-89.

<sup>32</sup> There is a resemblance here, as Hayek notes approvingly in HAYEK, *THE ROAD TO SERFDOM*, *supra* note 5, at 22, 74, 152-53, to the German "historical school" of jurisprudence, founded by Friedrich Carl von Savigny, who thought that the only legitimate law was customary law. The customary law Savigny had in mind was Roman law. See RICHARD A. POSNER, *FRONTIERS OF LEGAL THEORY* 195 (2001). This suggests certain difficulties in ascertaining what is to count as custom. Hayek does not discuss these difficulties; Leoni, however, writes admiringly of Roman law. See, e.g., LEONI, *supra* note 9, at 9-10, 82-86.

<sup>33</sup> See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (6th ed. 2003), especially part two of this work.

guide adjudication on economic grounds, specifically on the superiority of spontaneous to planned order because of the costs of information.

But one cannot read Hayek and think this his only ground for not wanting judges to meddle with economics. There is also his belief in the *Rechtsstaat*, the “rule of law” – the idea that the laws must be general, generally prospective, reasonably clear, administered rationally and impartially, and applicable to officials rather than just to citizens – in other words, no one is above the law. The rule of law is a normative notion rather than a description of what all law has in common and is therefore misleadingly named. It seems to imply that a society without it is lawless, whereas a society that lacks the rule of law is merely not a liberal society. Hayek falls into this verbal trap by using the term “true law” to denote legal doctrines, procedures, and so forth that conform to the rule of law.<sup>34</sup> This is a misleading usage because the opposite of “true law” in his sense is not false law or no law, but rather bad law. To equate law to the rule of law<sup>35</sup> is to embrace a natural-law conception of law; law is not law if it lacks certain civilized features. Hayek’s conception of the rule of law – and hence of law itself, given his equation of the terms – excludes a role for economics in adjudication because in his view any judge whose aspirations rise above enforcing custom is a lawless judge.

Natural lawyers are forever in quest of substantive or procedural principles that shall be criterial of law everywhere and for all time. But nothing of any use ever turns up. If there are universal principles of law, they are too vague and abstract to resolve any concrete issues. Invariably, therefore, natural-law theories are parochial; they would have no bite otherwise. Catholics defend a version of natural law based on Catholic theology, but free marketers like Hayek defend a version of natural law based on the needs (as he saw it) of the free market. Whether Catholics are right that abortion is murder, and whether Hayek is right that property rights should be sacrosanct, are not put on the road to being answered by being cast as questions about natural law.

What Hayek might constructively have argued is that the common law provides a better framework for economic development than the civil law does because judges in common law countries tend to have greater independence from the (more) political branches of government and so are more reliable enforcers of property rights. There is even evidence to support this view.<sup>36</sup> But Hayek was riding a different horse, or rather a different team. His theory of law is a peculiar mixture of the pragmatic and the dogmatic. The fundamental orientation is pragmatic – his Darwinesque ruling concept of “spontaneous order” is pragmatic, his theory of knowledge echoes (as we are about to see) John Dewey’s concept of epistemic de-

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<sup>34</sup> See, e.g., HAYEK, *THE CONSTITUTION OF LIBERTY*, *supra* note 9, at 208–09.

<sup>35</sup> Just as Lon Fuller did through his concept of the “internal morality” of the law. See LON L. FULLER, *THE MORALITY OF LAW* (1964). And for trenchant criticism, see also LLOYD L. WEINREB, *NATURAL LAW AND JUSTICE* 102–04, 295 n.6 (1987).

<sup>36</sup> See Paul G. Mahoney, *The Common Law and Economic Growth: Hayek Might Be Right*, 30 J. LEGAL STUD. 503 (2001); Simeon Djankov et al., *Legal Structure and Judicial Efficiency: The Lex Mundi Project* (World Bank, Oct. 2001), at [http://www.worldbank.org/research/pdffiles/lexmundi\\_paper.pdf](http://www.worldbank.org/research/pdffiles/lexmundi_paper.pdf); Edward Glaeser & Andrei Shleifer, *Legal Origins*, Q. J. OF ECON. (forthcoming).

mocracy, and his passionate commitment to the rule of law is based ultimately on a belief that even small departures from it put us on the road to ruin. The last belief is wrong, however, and gives Hayek's rule-of-law ideology its doctrinaire cast.

His position underscores the tension between liberalism and democracy. As one of his sympathetic commentators remarked, "Hayek is not opposed to democracy *as such*."<sup>37</sup> But in practice he sees democracy as paving the way to socialism. Believing as he did that Hitlerian tyranny "was the natural outcome of the replacement of the traditional rule of law and its liberal values by democratic legislation and administrative regulations on the basis of legislation,"<sup>38</sup> he wanted to surround democracy with so many restrictions that all that the people would be able to do would be to pick the officials and all that the officials would be able to do would be to administer the government; they could not establish rules of private behavior.

*The Road to Serfdom* draws a straight line between Bismarck's social welfare legislation and Hitler<sup>39</sup>—and the line runs through Hans Kelsen, a fellow Austrian and distinguished legal thinker whose theory of law, Hayek argued in a later book,

signaled the definite eclipse of all traditions of limited government . . . . There are no possible limits to the power of the legislator . . . . Every single tenet of the traditional conception of the rule of law is represented as a metaphysical superstition . . . . The possibilities which this state of opinion created for an unlimited dictatorship were already clearly seen by acute observers at the time Hitler was trying to gain power . . . . But it was too late. The antilibertarian forces had learned too well the positivist doctrine that the state must not be bound by law.<sup>40</sup>

Hayek is right that Kelsen taught that despotic governments, including "unlimited dictatorships," have law. But Kelsen never said they had good law, or the rule of law. The suggestion that Hitler might have been prevented from gaining power if only despotic laws had been denied the label "true laws"<sup>41</sup> merely shows Hayek's exaggerated belief in the influence of philosophy on society.

## II.

I mentioned John Dewey; he and Hayek, despite their differences in field, nationality, generation, and politics, have a number of things in common, and among these is the derivation of a comprehensive social, political, and economic theory from a theory about the structure or operation of the human brain, what I am calling "cognitive theory." In the case of Dewey, a philosopher, one would be

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<sup>37</sup> Gottfried Dietze, *Hayek on the Rule of Law*, in *ESSAYS ON HAYEK* 107, 130 (Fritz Machlup ed., 1976) (emphasis added).

<sup>38</sup> *Id.* at 133.

<sup>39</sup> HAYEK, *THE ROAD TO SERFDOM*, *supra* note 5, at 191–98.

<sup>40</sup> HAYEK, *THE CONSTITUTION OF LIBERTY*, *supra* note 9, at 238–39 (footnotes omitted); *see also* Dietze, *supra* note 37, at 131–33.

<sup>41</sup> HAYEK, *THE CONSTITUTION OF LIBERTY*, *supra* note 9, at 238.



inclined to substitute “epistemology” for “cognitive theory,”<sup>42</sup> and in the case of Hayek, who dabbled in biology, one might substitute “cognitive science,” but the similarity is considerable, and so the choice of a single term for both is warranted. My interest is in Hayek’s cognitive theory and its relation to some of the legal and policy issues that I discussed in Part I, but Dewey is a convenient stalking horse.

When Dewey began his philosophical inquiries in the late nineteenth century, the regnant tradition in the philosophy of knowledge, dating from Plato, emphasized the individual’s search for truth. Against this Dewey argued that scientific and other inquiry was actually oriented toward the *cooperative* acquisition of *useful* knowledge by whatever tools lay at hand, including imagination, common sense, know-how, and intuition. “A proposition may be said to be verified if it serves as a useful guide to future conduct.”<sup>43</sup> Knowledge thus includes tacit (“how to”) knowledge as well as the articulate knowledge acquired by formal reasoning and systematic empirical methods, for both are useful.

Dewey rejected what he called “the wholly *at large* view of truth which characterizes the absolutists,”<sup>44</sup> by whom he meant Plato and Plato’s followers. “It would be a great gain for logic and epistemology, if we would always translate the noun ‘truth’ back into the adjective ‘true,’ and this back into the adverb ‘truly,’” for “truth means *truths*, that is, specific verifications.”<sup>45</sup> There is no way of knowing when one has found “the truth” because one cannot step outside the universe and observe or estimate the correspondence between it and one’s descriptions. All that people are able to do, and all that most of them are interested in doing, is getting better control over their environment, enlarging their horizons, and enriching and improving their lives. The knowledge required for these endeavors is collective, being produced by the cooperative efforts of diverse inquirers—intelligence is distributed throughout the community rather than concentrated in an elite—and validated by the community’s judgment of its utility.

We might call this theory of knowledge “epistemic democracy.” No elite has a monopoly of truth. In fact, truth is always just out of reach, is at most a regulatory, an orienting, ideal. To Dewey, the proposal in Plato’s *Republic* of rule by an elite possessed of “a comprehensive rational understanding of eternal reality and truth, to be nurtured by a rigorous and extended higher education in all the mathematical sciences from arithmetic to astronomy,”<sup>46</sup> was quixotic.

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<sup>42</sup> Though Dewey is sometimes described as a cognitive theorist. See, e.g., Richard S. Prawat, *Cognitive Theory at the Crossroads: Head Fitting, Head Splitting, or Somewhere in Between?*, 42 HUMAN DEVELOPMENT 59 (1999). The fullest statement of Dewey’s cognitive theory can be found in JOHN DEWEY, *Logic: The Theory of Inquiry*, in 12 THE LATER WORKS, 1925–1953, at 1 (Jo Ann Boydston ed., 1986). Despite the title, *Logic* is perhaps better described as the work of a “descriptive psychologist” than as that of a “logician.” See Ernest Nagel, *Introduction to DEWEY*, *supra* at ix, xiii.

<sup>43</sup> Eric A. MacGilvray, *Experience as Experiment: Some Consequences of Pragmatism for Democratic Theory*, 43 AM. J. POL. SCI. 542, 545 (1999).

<sup>44</sup> John Dewey, *The Experimental Theory of Knowledge*, 15 MIND (n.s.) 293, 305 n.1 (1906) (emphasis in original).

<sup>45</sup> *Id.* at 305–06 (emphasis in original).

<sup>46</sup> Malcolm Schofield, *Approaching the Republic*, in THE CAMBRIDGE HISTORY OF GREEK AND ROMAN POLITICAL THOUGHT 190, 224 (Christopher Rowe & Malcolm Schofield eds., 2000).

Dewey dubbed his approach “experimentalism,” and the word aptly conveys the tenor of his thought. He commended the temperament that, impatient with convention and the accustomed ways of doing things—the sediment of habit—insists on trying now this, now that, in a creatively restless search for better means. The search yields, as a byproduct, better ends as well. As Dewey explained under the rubric of “interactionism,” our beliefs are a product not of pure thought but of the interplay of thought and action. When (to take a post-Deweyan example) airlines were deregulated, consumers did not “know” what kind of airline service they wanted; they learned what they wanted by experience with the various new services that the airlines, freed from the dead hand of regulation, offered. A central planner could not have designed the optimal configuration of a deregulated airline industry; the essential information concerning consumer demands simply did not exist before the deregulated services were offered, just as the person who took up ballet to improve posture could not know beforehand that the pleasure of ballet would become an end in itself.

If experts do not have the lock on knowledge that Plato thought they had, the epistemic basis for authoritarian rule by philosophers (or theologians, or Marxists, or other utopian social engineers) is removed. Similarly, any basis for the censorship of moral and political ideas on the grounds that they are false disappears along with any legitimating argument for a fixed and durable political hierarchy. As a result,

Democracy for Dewey is a good form of political organisation because it is the appropriate political modelling of a more general form of human interaction which has both epistemological and valuative advantages, and which finds its best realisation in a free scientific community devoted to experimental research. Just as such a research community is trying to invent theories that will allow us to deal with our environment in a satisfactory way, so a good human society would be one that was a kind of experimental community devoted to trying to discover worthwhile and satisfying ways of living.<sup>47</sup>

However, from the fact that Plato was wrong to think rule by philosophers desirable, it does not follow that democracy is the best form of government, for it is not the only alternative to rule by philosophers. There is an impermissible leap in Dewey’s claim that “intelligence is present most distinctively not in the contemplative life of the leisured elite, but in the workaday practicality of the masses.”<sup>48</sup> The “leisured elite” may lack the kind of intelligence necessary for good politics, but it doesn’t follow that the kind of practical intelligence possessed by ordinary people for navigating their personal and professional lives equips them to govern or make political judgments. Political democracy has to be defended on its own merits rather than by reference to its consistency with sound cognitive theory. We shall see that from psychological premises much like Dewey’s, Hayek reasoned not that

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<sup>47</sup> RAYMOND GEUSS, *HISTORY AND ILLUSION IN POLITICS* 124–25 (2001).

<sup>48</sup> MacGilvray, *supra* note 43, at 551.

the people should rule, but that the scope of government—the domain of democratic rule—should be contracted.

Dewey's cognitive theory was Darwinian. It derived from reflection on the type of mental operations that would be adaptive in the environment of early man. As Richard Rorty explains, speaking of pragmatists such as Dewey:

Pragmatists are committed to taking Darwin seriously. They grant that human beings are unique in the animal kingdom in having language, but they urge that language be understood as a tool rather than as a picture. A species' gradual development of language is as readily explicable in Darwinian terms as its gradual development of spears or pots, but it is harder to explain how a species could have acquired the ability to *represent* the universe—especially the universe as it really is (as opposed to how it is usefully described, relative to the particular needs of that species).<sup>49</sup>

That is, language, and mental operations more broadly, are tools for coping with the environment rather than methods for establishing the strong sense of truth (“the universe as it really is”) that Plato thought attainable by philosophers.

On a superficial analysis, Hayek's cognitive theory, to which I now turn, consists of just two propositions, and both are empirical (inductive or observational) rather than theory-based. The first, which underlies his attack on central planning, is that human knowledge is so widely distributed throughout the human population that no single person or even single organization could acquire enough of it to allocate the society's resources efficiently. This is a result of the division of labor, which has been carried to an extreme in modern society and greatly increases efficiency by enabling specialization, but which has brought about, as an unavoidable byproduct of specialization, a narrowing (along with a deepening) of the knowledge possessed by any single individual. He knows more about less.

So far there is convergence between Dewey and Hayek, both emphasizing the radical dispersion of knowledge across persons under the conditions of modernity. But they quickly diverge because Hayek, unlike Dewey (who was not an economist as Hayek was), saw that the price system was a method, probably the best and certainly a better one than central planning, of aggregating this dispersed knowledge. An individual may realize that a particular input that he needs in his business is likely to become scarce, so he buys up a large quantity and stores it. His action forces up the price of the input, the higher price induces other users of the input to economize on its use and by affecting their costs leads to adjustments in their own prices, all without their having to know anything about the economic conditions that lie behind the need for the adjustments. Price thus operates as a method (Hayek would say the method) by which private information is diffused throughout the entire market.<sup>50</sup>

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<sup>49</sup> Richard Rorty, *Pragmatism*, in 7 ROUTLEDGE ENCYCLOPEDIA OF PHILOSOPHY 633, 636 (Edward Craig ed., 1998) (emphasis in original).

<sup>50</sup> The clearest exposition of Hayek's theory of price is found in Hayek, *The Use of Knowledge in Society*, *supra* note 3.

The second proposition of Hayek's cognitive theory is that private or local information—the sort of unsystematized information possessed by an individual and illustrated in the preceding paragraph, as distinct from information that is codified in general principles stated in books or articles and thus is readily accessible—is impounded in rules as well as in prices.<sup>51</sup> A firm adopts a new practice, say a new method of compensating its employees. The firm might have hit on the new practice by accident or by hunch rather than by explicit cost-benefit analysis or other conscious reflection on how best to fit means to ends. Suppose the practice, whatever brought it about, results in lower costs and higher profits for the firm. That is important information to which the firm is likely to respond by codifying the practice as a rule. The difference between a rule and a standard (“profit maximization,” for example) that requires fresh analysis in every case is that a rule singles out one or a small number of facts to be outcome determining. The person applying the rule doesn't have to know its purpose or the net benefits of applying it in a particular case; all he has to know is whether the fact that triggers application of the rule is present or absent. Eventually the reason for the rule may be forgotten (and there may have been no reason, or at least no articulable reason), yet this may not matter; continued adherence to the rule will be a way of exploiting the information impounded in the rule without need for thought beyond what is necessary to determine whether the condition for the application of the rule is satisfied. Complying with a rule, like responding to a change in price, can be a method of utilizing knowledge without actually possessing knowledge. It is rational inertia.

I said that the practice might have been hit upon by accident or by hunch. The first possibility would represent the operation of trial and error; the second belongs to the domain of “tacit knowledge.”<sup>52</sup> People know how to do many things that they cannot explain. A person who knows how to ride a bicycle cannot transfer that knowledge in words to another person (that is, enable the other person to know how to ride a bicycle) in the way that a person who knows how to bake a cake can transfer that knowledge by handing the other person a detailed recipe, which the person can use to actually bake a cake. Hayek realized that a great deal of knowledge, including a great deal of the knowledge utilized in business, is tacit, inarticulable, and therefore uncommunicable. He believed this in part because he thought a complex system could be understood only by a more complex system, and hence the mind could never fully understand itself. I don't know whether that

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<sup>51</sup> See, e.g., FRIEDRICH A. HAYEK, *NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS* 3, 7, 10 (1978) [hereinafter HAYEK, *NEW STUDIES*]; Friedrich A. Hayek, *Rules, Perception, and Intelligibility*, in 48 *PROCEEDINGS OF THE BRITISH ACADEMY* 321 (1962).

<sup>52</sup> The modern philosopher most responsible for emphasizing the importance of tacit knowledge was Michael Polanyi. See, e.g., MICHAEL POLANYI, *The Logic of Tacit Inference*, in *KNOWING AND BEING: ESSAYS* 138 (Marjorie Grene ed., 1969). The importance of tacit knowledge in Hayek's cognitive and economic theory is emphasized in (among other places) Richard N. Langlois & Müfit M. Sabooglu, *Knowledge and Meliorism in the Evolutionary Theory of Friedrich A. Hayek*, in *EVOLUTIONARY ECONOMICS: PROGRAM AND SCOPE* 231 (Kurt Dopfer ed., 2001). See also STEVE FLEETWOOD, *HAYEK'S POLITICAL ECONOMY: THE SOCIO-ECONOMICS OF ORDER* (1995), particularly chapter 7, for a good discussion of Hayek's theory of knowledge.

makes any sense. Whatever its origin in his thinking, his belief in the importance of tacit knowledge was correct and strengthened his challenge to the feasibility of central planning. If much of the knowledge that is scattered among the millions of economically active persons in a society is tacit, then no matter how great the intellectual capacity of the central planner is, he (or it, if we speak more realistically of an agency rather than of an individual) will not be able to obtain all the information needed because much of it will be in forms uncommunicable—except through pricing. The price system is the alternative to central planning, and, to the extent that knowledge is tacit, it would be a superior alternative even if the central planner had an unlimited capacity to absorb and analyze data.

Hayek—this is his most important contribution to economics, and it comes directly from his cognitive theory—was offering a new rationale for the price (or market) system. The old rationale, the rationale associated with classical or neo-classical economics (as distinct from “Austrian” economics, the economics of Hayek, his predecessors Carl Menger and Ludwig von Mises, and his successors), was that the price system was a method of overcoming self-interest, of turning private vice into public virtue, of leading selfish individuals by an invisible hand to serve the public interest. People in this view are rational not only in the sense of being committed to means-end reasoning but also in the sense of having a clear perception of the end, and of the costs and benefits of the alternative means to that end. But they are too self-interested, too deficient in altruism, to be trusted to use their knowledge for social ends, and so the trick is to induce them to behave in a way that will maximize social welfare as a whole, and the price system is the trick. Hayek did not think the main problem to which the price system was the solution was self-interest and a resulting shortage of altruism; he thought that people needed the price system in order to overcome the deficits in their knowledge.

Hayek’s second cognitive principle—the importance of rules as a method for dealing with the knowledge deficits that gave rise to his defense of the price system—completes his political and legal theory. With knowledge dispersed and much of it tacit, there is no way a central authority, such as a legislature or a court, can obtain and integrate the knowledge necessary for sensible decisions on issues of law or policy. The dispersed and tacit knowledge will, however, be found aggregated in rules that grow out of the practices of the relevant community, in other words, customs. Since the relevant knowledge is impounded in customs, the proper function of legislatures and courts is in the main merely to ascertain and enforce them. Hayek, as we know, acknowledges that legislatures also have to pass tax and other laws relating to the operation of the government and that the courts from time to time have to tidy up the customary rules that they enforce. But for the most part, law and policy in his conception of the well-ordered state are the products of a decentralized system for aggregating and impounding information that is quite like the price system itself, the difference being that the information is impounded in and conveyed by rules rather than prices. Voters, he believed, tend to be hopelessly ignorant about political issues because such issues are not within a voter’s local knowledge. It follows that government should be as decentralized as

possible because people are more knowledgeable about local than about regional or national affairs.

So far I have described Hayek's cognitive theory as a matter merely of observations about the locus (dispersed) and character (often tacit and hence uncommunicable in words) of knowledge. But there is more. There is a theory of mind that regards perceptions as the product of the interaction between sensory impressions—the impact of the external world on the organs of sense, such as sight and hearing—and a classificatory apparatus in the brain.<sup>53</sup> This is a Kantian insight. In Kant's epistemology, sensory impressions are made intelligible by being subjected to mind-generated categories such as causation and time. Hayek's categories differ in two ways: the individual's classificatory apparatus is the product of idiosyncratic factors of personality and culture rather than just of basic hard-wired features of the brain (presumably the capacity to perceive two events as cause and effect is hard wired) and thus differs across individuals; and the apparatus is not fixed but can be altered by experience. In other words, people see (literally and figuratively) things differently, and the way in which they see things changes in response to changes in the environment. The first point highlights the dispersal of knowledge, scattered as a result of differences in perspective rather than just differences in raw information—and how is the central planner to correct for the possible distortions in his own perspective? The second point emphasizes the mutability of knowledge, another obstacle to the central planner, who is bound to encounter a long delay between collecting information and acting on it.

Hayek's analysis of human cognition, both in its emphasis on the dispersal and the tacit character of knowledge and in relating these to the mind's processing of the impressions it receives from the outside world, makes an impressive theoretical case, now amply confirmed by experience, against central planning whether confined to the economy or extended across the entire range of public issues in a society. The limitation of his approach, however, is that with central planning and other forms of utopian social engineering now so thoroughly discredited, it is unclear what if any significance Hayek's cognitive theory and the political-economic theory that he derived from it retain. This problem is central to the failure of post-Hayekian Austrian economics to enter the mainstream of economic, political, and legal thought.

Hayek was explicit that he was comparing the price system to *economy-wide* central planning, and the spontaneous order created by custom to a *total* (usually a totalitarian) political-judicial system that imposes its own ideas of what is right on a

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<sup>53</sup> The fullest exposition of Hayek's theory of mind is in FRIEDRICH A. HAYEK, *THE SENSORY ORDER: AN INQUIRY INTO THE FOUNDATIONS OF THEORETICAL PSYCHOLOGY* (1952). This is a difficult work. For a helpful summary, see G.R. Steele, *Hayek's Sensory Order*, 12 *THEORY & PSYCHOLOGY* 387 (2002). The fullest effort that I am aware of to relate Hayek's cognitive theory to his economic and political theories is Steven Horwitz, *From The Sensory Order to The Liberal Order: Hayek's Non-Rationalist Liberalism*, 13 *REV. AUSTRIAN ECON.* 23 (2000). Horwitz's article also contains a lucid summary of Hayek's cognitive theory. Also quite helpful in that regard is Bruce Caldwell, *Hayek, The Sensory Order, and Psychology* (unpublished manuscript, on file with author).

citizenry that it does not consult.<sup>54</sup> He was not evaluating a mixed system, in which there is a degree of personal freedom but also a degree of imposed order. A mixed system is what we and our peer nations have; what help Hayek's thought offers to someone trying to evaluate such a system is unclear.

Consider an economist who shares Hayek's skepticism about the utility of the key concepts in neoclassical economics of maximization and equilibrium. Hayek is skeptical because both maximization and equilibrium imply the existence of a position, achieved by the firm or the individual and by a market respectively, from which any change would reduce welfare; and given constantly changing conditions and incomplete information, no one, and no market, is ever in such a position. Markets are never in equilibrium—even with completely up-to-the-date information but imperfect foresight, the time required to translate the latest information into a new set of prices would prevent the achievement of equilibrium—and profit or welfare is never being maximized.

The economist I am thinking of is Ronald Coase. He shares Hayek's skepticism about maximization and equilibrium.<sup>55</sup> But he is also famous for (among other things) his theory of the firm, which proposes that economic activity will be brought inside a firm rather than conducted by means of contracts when the cost of directing economic activity by fiat (the employer telling his employees what to do and paying them a salary rather than buying their output from them) is lower than the cost of contracts—that is, of using the market.<sup>56</sup> In other words, sometimes the price system is the more efficient way of organizing production, and sometimes the command and control method of production within a firm is more efficient. But the command and control method of directing production is just central planning writ small. A firm that must decide whether to buy an input or make it itself (signifying production by fiat within an organization rather than by market transactions) is not always mistaken when it opts for the latter course of action, any more than families are mistaken when they do not use prices to direct the household production of their members. Sometimes—in fact rather often—it is more efficient to aggregate information across the persons who possess it by communication in the form of words communicated within a centralized organization rather than in the form of prices. The pervasive role of the firm in modern economies shows that the price system is not always the most efficient method of aggregating the information that is relevant to some productive process.

Of course the command and control method is not *always* more efficient than the price system, for if it were, then society-wide central planning would be feasible after all, and Hayek had shown that it is not. But *sometimes* it is the more

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<sup>54</sup> See, e.g., Hayek, *The Use of Knowledge in Society*, *supra* note 3, at 520; HAYEK, *NEW STUDIES*, *supra* note 51, at 19–20.

<sup>55</sup> See, e.g., R.H. COASE, *THE FIRM, THE MARKET, AND THE LAW: ESSAYS ON THE INSTITUTIONAL STRUCTURE OF PRODUCTION* 4 (1988); RICHARD A. POSNER, *OVERCOMING LAW* 412, 419 (1995).

<sup>56</sup> See Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937); see also Elias K. Khalil, *Information, Knowledge and the Close of Friedrich Hayek's System*, 28 *E. ECON. J.* 319, 331 (2002) (elaborating on the anti-Hayekian character of Coase's theory of the firm).

efficient method, and the important question once the extremes are rejected is *when* it is more efficient; on that question Hayek's analysis sheds no light. And similarly with custom. Sometimes it makes sense for law to follow custom because custom may indeed impound the information relevant to the activity that the custom concerns. The set of customs known as the "law merchant" provided, and rightly so, the foundation of modern Anglo-American contract law. But often it makes no sense to base law on custom because a custom may reflect conditions that have changed—lacking central direction, custom tends to lag behind social and economic change—or may be the product of incentives that diverge from the socially desirable, as in the examples given earlier of a custom of not compensating victims of an industry's noncost-justified pollution or careless injuries, or of refraining from price competition. Customs may in short be vestigial and dysfunctional. And again, on the crucial question of *when* law should reject custom, Hayek casts no light.

Hayek must be understood as a man of his time, battling contemporary enemies—socialism in its various guises—with apt and powerful weapons, defeating them thoroughly, and earning in consequence an honored place in the history of political and economic thought, but failing to set forth principles or methods that could be used to solve the problems of the next stage, the postsocialist stage, of economic and political ordering. He had a keen sense of how individuals coordinate their activities through contract and through custom, yet it's as if he had never heard of organizations.

I want finally to consider the significance of Hayek's cognitive theory for three current movements in social science: Austrian economics, the law and economics movement (to which I have already alluded), and behavioral economics. Austrian economics is in part an attempt, considered by most modern economists however to be marginal,<sup>57</sup> to tease out the implications of Hayek's cognitive theory and the critique of central planning that flows from it, for modern political and economic issues. That is not all there is to Austrian economics; there are theories about the business cycle, the monetary system, and capital formation as well, but they are not relevant to the concerns of this paper. The endeavor of Hayek's successors that I am concerned with has foundered on his failure to have bequeathed to them any guidance on how to extend his approach to problems other than the problem of central planning. With central planning no longer on the political agenda of any major nation, the focus of the Austrian economists who follow in Hayek's footsteps has become the critique of neoclassical economics, viewed as the intellectual underpinning of central planning. (I do not regard as distinctive, except in vocabulary, efforts to extend the Austrian critique of central planning to government regulation in general—to "interventionism" as Ikeda calls it in an interest-

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<sup>57</sup> For a polite assessment by a mainstream economist, see Sherwin Rosen, *Austrian and Neoclassical Economics: Any Gains from Trade?*, J. ECON. PERSP., Autumn 1997, at 139. As he says at the outset of his article, "Austrian economics has been important to the development of modern economics, but its role in current practice is much diminished." *Id.* at 139.



ing Austrian-style book<sup>58</sup>—an extension that very largely merges Hayekian critique into the neoclassicists' public-choice theory.) The animating concern is that the belief in central planning had its source in the neoclassical economists' concept of man as a rational maximizer, a concept that implies such complete knowledge of the costs and benefits of alternative methods of satisfying human wants as to make the omniscient central planner a realistic aspiration. There was a time that many neoclassical economists believed this. The heyday of that belief was the 1930s, and so it is no surprise that Hayek and Coase should have associated core concepts of neoclassical economics, such as maximization and equilibrium, with central planning, which both of them detested.

But the belief in central planning was not organic to neoclassical economics and is not organic to the rational-choice model of economic behavior, which amplifies the neoclassical approach. The Austrian critique overlooks the difference between a model and a description. For some purposes the drastic simplification of reality that is found in a model of perfect competition (one assumption of which is complete information) is a harmless, indeed a beneficent, parsimony; for all its unrealism, the model can be used for example to generate accurate predictions of the effect on price of an excise tax. Its phenomenological, its psychological, sparseness need no more invalidate its conclusions than the simplifications employed in models in the physical sciences. Even nonmentalistic models may be fruitful in economic analysis, as illustrated by Gary Becker's nonrational explanation for the Law of Demand (the principle that demand curves are downward sloping, i.e., that price and quantity are inverse)<sup>59</sup> or by economic models of animal behavior.<sup>60</sup> Concepts such as equilibrium and maximization are of enormous analytic value even though, realistically, they describe tendencies or approximations rather than achieved goals of the economic system.

Granted, in the case of many economic phenomena, explanation requires more complex models than that of perfect competition. For example, since perfect competition implies that the price of a product is everywhere the same if the cost is everywhere the same, the model of perfect competition will not explain a dispersion of prices that is due to the existence of search costs. The gallon of gasoline for which I pay \$1.75 may be selling for \$1.50 a block away, yet if I and other consumers do not know this, the disparity in price may persist. The existence of search costs and other information costs is now an established feature of rational-choice economics and is immune to Hayekian criticisms of neoclassical economics. To say that neoclassical economics implies that economic actors "can never err"<sup>61</sup> is to misunderstand neoclassical economics as it is practiced today. Austrian economics is attacking a *dirigiste* version of neoclassical economics that vanished long ago.

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<sup>58</sup> SANFORD IKEDA, DYNAMICS OF THE MIXED ECONOMY: TOWARD A THEORY OF INTERVENTIONISM 31–54 (1997).

<sup>59</sup> See Gary S. Becker, *Irrational Behavior and Economic Theory*, 70 J. POL. ECON. 1 (1962).

<sup>60</sup> GARY S. BECKER, A TREATISE ON THE FAMILY 307–23 (enlarged ed. 1991).

<sup>61</sup> Horwitz, *supra* note 53, at 29.

The rational-choice model is dominant in the economic analysis of law for reasons unrelated to insensitivity to costs of information. Austrian economists misunderstand this and as a result criticize economic analysis of law for resting on an unrealistic concept of human behavior and as constituting indeed a form of central planning.<sup>62</sup> The paradoxical reason that economic analysis of law emphasizes rational choice is that so much of the behavior it deals with is “noneconomic” in the sense of not taking place in explicit markets. Theft, murder, accidents, litigation, legislation, marriage and divorce, bequests, censorship, pollution, discrimination, and other staples of legal regulation are nonmarket activities in the sense of not being explicitly priced. But to the extent that the participants in these activities are rational, not in the sense of being fully informed but in the sense of responding to incentives, economic models can explain much of their behavior and provide guidance for improving its regulation. As most of these are areas that cannot be left to the governance of custom, there is no alternative to using conscious reflection in the design of legal rules.

Hayek never quite claimed that all knowledge is tacit, that there is no such thing as fruitful employment of instrumental reasoning; but the examples he offered of it were meager (his main example was engineering). And, paradoxically in so learned a man, there is a streak of anti-intellectualism in his extreme skepticism about the utility of conscious reason as a tool of social understanding and improvement.<sup>63</sup> Neither he nor his successors have offered convincing reasons for believing that instrumental reasoning guided by economic models can never improve government regulation, for example by selected measures of deregulation and privatization that Hayekians, as opponents of big government, should applaud. Nor are they able to distinguish satisfactorily between government and business bureaucracies,<sup>64</sup> so that the logic of their critique is that society should aspire to restore the atomistic structure of the pre-Industrial Revolution economy.

I anticipate the response that the real disagreement between the Austrians and the neoclassicists is over the subjective theory of value, but I don't think they do disagree over this. Both schools of thought agree that people derive different amounts of utility from the same goods and services; otherwise, indeed, there would be no gains from trade. And they agree that subjective evaluations are difficult to measure, which is one of the reasons that both favor markets. Where they differ is that the neoclassicists have greater faith than the Austrians in the ability of judges and other government officials to mimic markets (that is, to bring about the allocation of resources that the market would bring about) in those common situations in which market transaction costs are so great as to preclude value-

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<sup>62</sup> See, e.g., *id.* at 36.

<sup>63</sup> See, e.g., FRIEDRICH A. HAYEK, *THE COUNTER-REVOLUTION OF SCIENCE: STUDIES IN THE ABUSE OF REASON* (1952); Friedrich A. Hayek, *Our Intellectuals and Their Tradition of Reasonable Socialism*, in 1 *THE COLLECTED WORKS OF FRIEDRICH A. HAYEK: THE FATAL CONCEIT: THE ERRORS OF SOCIALISM* 52 (W. W. Bartley III ed., 1988).

<sup>64</sup> See, e.g., IKEDA, *supra* note 58, at 56.

maximizing exchanges.<sup>65</sup> The neoclassical law and economics scholars believe in other words that courts can do the kind of simple cost-benefit analysis that indicates, for example, that punishing careless drivers will increase social value. The disagreement between Austrians and neoclassicists is about the degree to which government regulation is doomed to failure because of inability to obtain the information necessary for ascertaining value. There is nothing in Hayek's cognitive theory that would resolve this disagreement.

Behavioral economics refers to the growing use of the insights of cognitive psychology to explain economic phenomena and guide economic policy.<sup>66</sup> The behavioralists emphasize quirks in reasoning that prevent people from always thinking through a problem rationally and also dispositions, such as a sense of fairness or of vengefulness, that do not fit the model of rational self-interest employed in neoclassical economics. The behavioralists thus share with Hayek and his successors in Austrian economics a skepticism about the power of rational thought to guide behavior. But the particular quirks and dispositions that they emphasize do not play a role in Hayek's theories or that of his successors, and on the other hand, the behavioralists do not share Hayek's interest in tacit knowledge, with the important exception of Gerd Gigerenzer and his associates. What some other behavioralists regard as quirks that interfere with rational thought, Gigerenzer redescribes as useful heuristics—shortcuts that are often more efficient than the elaborate, but also costly and sometimes inaccurate or inconclusive, reasoning methods that the shortcuts replace.<sup>67</sup> His work resembles that of psychologists and philosophers who emphasize the cognitive role of the emotions, also, as shortcuts that frequently are more efficient than fully articulate reasoning methods.<sup>68</sup> (It is more efficient to jump from the path of a speeding car without thought than it is to explicate the full decision tree which shows that jumping out of the way is indeed the optimal response.) Perhaps Austrian economics will be able to make use of the psychological literature on heuristics and emotions to enrich Hayek's cognitive theory.

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<sup>65</sup> The extreme pessimism of the Austrians regarding government intervention in the economy is illustrated by IKEDA, *supra* note 58.

<sup>66</sup> See, e.g., Eldar Shafir & Robyn A. LeBoeuf, *Rationality*, 53 ANN. REV. PSYCHOL. 491 (2002); BEHAVIORAL LAW AND ECONOMICS (Cass R. Sunstein ed., 2000); RICHARD H. THALER, QUASI RATIONAL ECONOMICS (1991).

<sup>67</sup> See, e.g., GERD GIGERENZER ET. AL., SIMPLE HEURISTICS THAT MAKE US SMART (1999); Gerd Gigerenzer, *Bounded Rationality: The Study of Smart Heuristics*, in HANDBOOK OF JUDGMENT AND DECISION MAKING (D. Koehler & N. Harvey eds., forthcoming). The issue is less inconsistency as a difference in emphasis. The cognitive quirks interfere with *rational* thought, but there is emotional thought as well, and often it is more efficient.

<sup>68</sup> See, e.g., MARTHA C. NUSSBAUM, UPHEAVALS OF THOUGHT: THE INTELLIGENCE OF EMOTIONS (2001); POSNER, *supra* note 32, at 225–51; JON ELSTER, ALCHEMIES OF THE MIND: RATIONALITY AND THE EMOTIONS 283–331 (1999); John Deigh, *Cognitivism in the Theory of Emotions*, 104 ETHICS 824 (1994); KEITH OATLEY, BEST LAID SCHEMES: THE PSYCHOLOGY OF EMOTIONS (1992); RONALD DE SOUSA, THE RATIONALITY OF EMOTION (1987); R. B. Zajonc, *Feeling and Thinking: Preferences Need No Inferences*, 35 AM. PSYCHOLOGIST 151 (1980).

