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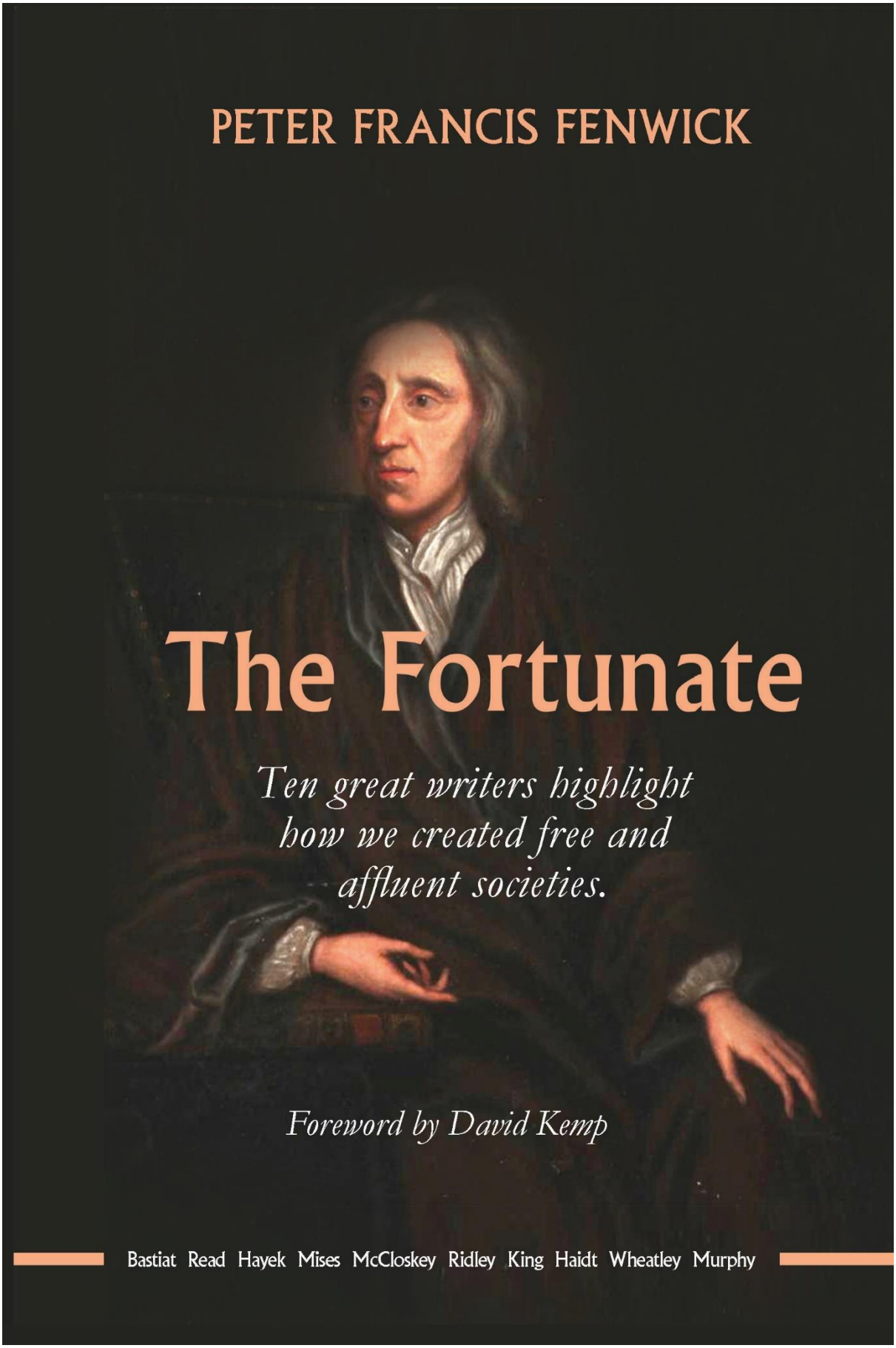

The Fortunate

Ten great writers highlight how we created free and affluent societies.

Foreword by David Kemp

Bastiat Read Hayek Mises McCloskey Ridley King Haidt Wheatley Murphy

3. Economic decisions are best made by the man on the spot

A funny thing happened in 2020 and 2021. Throughout the world, citizens in many mature democracies surrendered their liberties without a whimper and complied with onerous regulations in response to the coronavirus pandemic. Political leaders enjoyed the sudden thrill of authoritarian power, all the while hiding behind the expert advice of their chief health officers. At both international and local levels, well developed pandemic plans were abandoned without explanation or justification.[1]

On October 4, 2020, Dr. Sunetra Gupta from Oxford, Dr Jay Bhattacharrya from Stanford, and Dr Martin Kulldorf from Harvard issued their Great Barrington Declaration.

> *As infectious disease epidemiologists and public health scientists we have grave concerns about the damaging physical and mental health impacts of the prevailing COVID-19 policies and recommend an approach we call Focused Protection.*[2]

Not only was their advice ignored but they were subject to "an onslaught of insults, personal criticism, intimidation and threats." [3] Their colleague, Dr Scott Atlas, suffered a similar fate which he has documented in his memoire *A Plague upon our House.*[4]

Our experiences in Melbourne, Australia, were like those in many other cities around the world, but lockdowns and other restrictions lasted longer. Curfews were imposed, keeping us locked in our homes at night. In the daytime we were permitted to venture out for an hour each day, within 5 kilometres of our homes and only for exercise and essential shopping – social or recreational activities were not allowed. Businesses deemed to be non-essential were forced to close, as were schools. We were not allowed to invite extended family, friends, or neighbours into our homes. Families were unable to visit relatives in nursing homes and hospitals. Elective surgery was deferred indefinitely. There was no public entertainment: art galleries, libraries, concert halls, cinemas and sporting venues were all closed. Events were banned, including weddings, funerals and other gatherings. Travel was curtailed. Interstate travel was not permitted for any reason other than those deemed to be essential. International travellers, including students and backpackers, were forbidden to enter the country for study or work. Any Australian resident who happened to be overseas at the time was unable to return. The regulations were enforced uniformly, regardless of the local incidence of the virus.

The expert advice for these regulations came from chief health officers. Significantly, they were not expert in matters of business, sociology, or education. Even their knowledge of medicine was limited. Some had spent most of their working life in administration rather than practicing their profession. They had no way of balancing their decisions by considering the impact on the livelihoods of the owners and workers in the businesses they shut down, the impact on the education and social development of the children unable to go to school, or the impact on the mental health of people

[1] Sabhlok (2020)
[2] https://gbdeclaration.org
[3] https://www.dailymail.co.uk/debate/article-8899277 17
[4] Atlas (2021)

denied the opportunity to socialise with family, friends, and workmates. Many of the adverse consequences may be long-term and may not be noticed for years.

Thus, officials with insufficient skill, expertise, knowledge, and data have been making decisions which impact the lives and livelihoods of millions both now and in the future. Their solutions have not addressed the whole problem. They have not taken account of all the factors. They have been sub-optimal, unbalanced, and sometimes punitive. The reasons for arbitrary and inconsistent regulations were never explained. Maybe there were no reasons, just gut feel. Maybe they were not explained because they would not have withstood public scrutiny.

Your average citizen perfectly understands the need for hygiene, to stay at home if unwell, when it is sensible to wear a mask, why it is a good idea to get vaccinated, and so on. Businesses are accustomed to creating safe working environments. Schools care for their students; artists for their audiences. So here is a thought. Maybe we could have achieved the same health outcomes without the negative consequences of mandatory lockdowns if governments had been prepared to provide frequent, detailed, accurate and current information at the local level and then left it to citizens to make their own sensible decisions – in other words if the government shared its information and made recommendations not regulations.

By making it voluntary they may have been more likely to get compliance. When people are treated with respect and given information, they can trust they respond positively. Observe that tens of thousands of citizens lined up for tests and vaccinations.

It is time to consider the evidence. International comparative data shows that there was no beneficial association between lockdowns and the
incidence of COVID-19 deaths.[5] [6] [7] [8] [9]

It is not simply that lockdowns don't work. We must face the fact that the state is an ineffective institution for the control of a pandemic. Only adult behaviour by informed citizens can resolve such problems.

In the next essay, *The Use of Knowledge in Society,* F.A. Hayek addresses the generic problem of how to make rational economic decisions. Hayek bases his analysis on three profound concepts. First, that not all knowledge is scientific; there is also the knowledge of time and place. Second, that knowledge of time and place is held by millions of individuals. Third, data that is aggregated loses nuance.

Hayek explains that sound economic decisions cannot be made centrally by experts or bureaucrats, because they can never have all the knowledge needed. Moreover, they lack transient information about people, local conditions and special circumstances.[10] That is why, in addressing the coronavirus pandemic, we must delegate responsibility to the man on the spot.

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5 Allen (2021)
6 Frijters, Foster and Baker (2021)
7 Agrawal, Cantor, Sood, and Whaley (2021)
8 https://c2cjournal.ca/2021/03/do-lockdowns-make-a-difference-in-apandemic/
9 Atlas (2021), p. 298 - 310
10 That is, the knowledge of time and place

For example, you can use population statistics to determine how many vaccine vials are required to vaccinate all Australians over the age of 18 years. But if you want to know how many residents of an aged-care home to vaccinate next week, then you need to know how many missed out last week due to an outbreak of diarrhoea (or some other reason), and whether sufficient nursing staff can be rostered to administer the injections. Similarly, a local real estate agent is likely to have a better idea of the value of your home than the Australian Bureau of Statistics, because they have current knowledge of what buyers are looking for and how much they are prepared to pay. We see this also in the skills of professionals and tradespeople. They make well-founded decisions by drawing on their lifetime of work experience. There is stuff they know that can never be recorded in textbooks, nor taught in a classroom.

In business, managers make decisions every day, varying their processes to meet changes in demand for their products, or the supply of raw materials, or the unexpected failure of a machine, or the unavailability of staff. They are responding to information that is local and immediate. But what about data that is neither local nor immediate? How does the business manager acquire such necessary information with minimal effort?

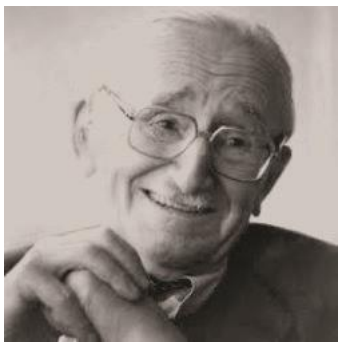
Hayek's solution is the price mechanism. He extols it as a marvel – one of the greatest triumphs of the human mind. Hayek illustrates the effectiveness of the price mechanism by explaining what happens when, somewhere in the world, a tin mine collapses, or some new opportunity arises for the use of tin. It does not matter which. The price of tin rises and consequently business managers throughout the world must economise on tin or find alternatives. The price system enables the business manager to make decisions without needing to know the cause of the changes in demand. It is a conduit for the minimum information required to make decisions.

The problem for a planned economy is that it does not have a price mechanism. It has no way of allocating scarce resources; no way of making rational economic choices. Mises explained this deficiency one hundred years ago in his paper on economic calculation. [11]

The price mechanism is under-recognised and undervalued, possibly because no-one discovered it and no-one designed it. It facilitates the division of labour upon which our prosperity is based. It enables individuals to choose their employment and to use their knowledge and skills to their own and the community's optimal benefit. The price mechanism enables society to use the knowledge of millions of people to optimise the allocation of scarce economic resources. It is a profound concept. A miracle even. It enables economic decisions to be made by the man, or woman, on the spot.

[11] Ludwig von Mises, *Economic Calculation in the Socialist Commonwealth,* 1920

F.A. Hayek (1899–1992)



Friedrich August von Hayek was born in Vienna, Austria into a distinguished family of scholars, which included his cousin, the philosopher Ludwig Wittgenstein.

Hayek obtained his doctoral degrees in law and political science from the University of Vienna, where he also participated in Ludwig von Mises' *privatseminar*.

In 1974, Hayek and Gunnar Myrdal were jointly awarded the Nobel Memorial Prize in Economic Sciences 'for their pioneering work in the theory of money and economic fluctuations and for their penetrating analysis of the interdependence of economic, social and institutional phenomena'.

Hayek's academic life was spent mostly at the London School of Economics (1931–50), the University of Chicago (1950–62) and the University of Freiburg (1962–68). He was a pioneer in monetary theory and a leading proponent of classical liberalism.

In 1947, Hayek invited a group of distinguished economists, philosophers and historians – including Frank Knight, Karl Popper, Ludwig von Mises, George Stigler and Milton Friedman – to a meeting at Mont Pelerin in Switzerland, where they agreed to form The Mont Pelerin Society. He remained its president until 1961. The society is still active, continuing to fight for the central values of civilisation: the essential conditions of human dignity and freedom, for freedom of thought and expression, and against the imposition of arbitrary power on the individual and the voluntary group.

Early in his career, Hayek recognised that the spontaneous order of the unplanned free market coordinated human actions efficaciously. His concern was that it sometimes failed, leaving large numbers of people unemployed. In his analysis of the business cycle, Hayek identified that the major problem was the increase in the supply of money. Government intervention, through the central banks, drove interest rates down and made credit artificially cheap. Consequently, businesses received false signals from the credit market and made investment errors, particularly in relation to capital goods. Moreover, as the credit was not created by savings, the customers did not have the funds to purchase the resulting consumer goods. Then these malinvestments failed and a bust ensued.

During the 1930s, with general public approval, governments intervened in the social and economic life of their nations. There was a distrust for the market and disdain for individual decision-making. Hayek feared that empowering governments with increasing economic control would lead to the horrors of Nazi Germany and fascist Italy, rather than the desired utopia. In his best-known work, *The Road to Serfdom* (1944), Hayek meditates on the relationship between government authority and

individual liberty. It is a passionate warning of the dangers of state control over the means of production.

Hayek's enduring legacy that centrally controlled economies are doomed to failure because they encroach unacceptably on personal liberty and that they are unable to allocate scarce resources efficiently were explained in *The Constitution of Liberty* (1960).

> Hayek's paper, *The Use of Knowledge in Society* is an important contribution to economic thought. It explains how individuals acquire and utilise knowledge through the market process. It provides the theoretical underpinning for the tale about the price miracle, told so well by Leonard Read in *I, Pencil*. It is a complex essay filled with abstract ideas, but the effort needed to understand it is worthwhile. Persevere. A complete understanding may require a second or third reading.

The use of knowledge in society

F.A. Hayek

What is the problem we wish to solve when we try to construct a rational economic order? On certain familiar assumptions the answer is simple enough. *If* we possess all the relevant information, *if* we can start out from a given system of preferences, and *if* we command complete knowledge of available means, the problem which remains is purely one of logic. That is, the answer to the question of what is the best use of the available means is implicit in our assumptions. The conditions which the solution of this optimum problem must satisfy have been fully worked out and can be stated best in mathematical form: put at their briefest, they are that the marginal rates of substitution between any two commodities or factors must be the same in all their different uses.

This, however, is emphatically *not* the economic problem which society faces. And the economic calculus which we have developed to solve this logical problem, though an important step toward the solution of the economic problem of society, does not yet provide an answer to it. The reason for this is that the "data" from which the economic calculus starts are never for the whole society "given" to a single mind which could work out the implications and can never be so given.

The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use 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. The economic problem of society is thus not merely a problem of how to allocate "given" resources – if "given" is taken to mean given to a single mind which deliberately solves the problem set by these "data." It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge which is not given to anyone in its totality.

This character of the fundamental problem has, I am afraid, been obscured rather than illuminated by many of the recent refinements of economic theory, particularly by many of the uses made of mathematics. Though the problem with which I want primarily to deal in this paper is the problem of a rational economic organization, I shall in its course be led again and again to point to its close connections with certain methodological questions. Many of the points I wish to make are indeed conclusions toward which diverse paths of reasoning have unexpectedly converged. But, as I now see these problems, this is no accident. It seems to me that many of the current disputes with regard to both economic theory and economic policy have their common origin in a misconception about the nature of the economic problem of society. This misconception in turn is due to an erroneous transfer to social phenomena of the habits of thought we have developed in dealing with the phenomena of nature.

In ordinary language, we describe by the word "planning" the complex of interrelated decisions about the allocation of our available resources. All economic activity is in this sense planning; and in any society in which many people collaborate, this planning, whoever does it, will in some measure have to be based on knowledge which, in the first instance, is not given to the planner but to somebody else, which somehow will have to be conveyed to the planner. The various ways in which the knowledge on which people base their plans is communicated to them is the crucial problem for any theory explaining the economic process, and the problem of what is the best way of utilizing knowledge initially dispersed among all the people is at least one of the main problems of economic policy – or of designing an efficient economic system.

The answer to this question is closely connected with that other question which arises here, that of *who* is to do the planning. It is about this question that all the dispute about "economic planning" centers. This is not a dispute about whether planning is to be done or not. It is a dispute as to whether planning is to be done centrally, by one authority for the whole economic system, or is to be divided among many individuals. Planning in the specific sense in which the term is used in contemporary controversy necessarily means central planning – direction of the whole economic system according to one unified plan. Competition, on the other hand, means decentralized planning by many separate persons. The halfway house between the two, about which many people talk but which few like when they see it, is the delegation of planning to organized industries, or, in other words, monopoly.

Which of these systems is likely to be more efficient depends mainly on the question under which of them we can expect that fuller use will be made of the existing knowledge. And this, in turn, depends on whether we are more likely to succeed in putting at the disposal of a single central authority all the knowledge which ought to be used but which is initially dispersed among many different individuals, or in conveying to the individuals such additional knowledge as they need in order to enable them to fit their plans with those of others.

It will at once be evident that on this point the position will be different with respect to different kinds of knowledge; and the answer to our question will therefore largely turn on the relative importance of the different kinds of knowledge; those more likely to be at the disposal of particular individuals and those which we should with greater confidence expect to find in the possession of an authority made up of suitably chosen experts. If it is today so widely assumed that the latter will be in a better position, this is because one kind of knowledge, namely, scientific knowledge, occupies now so prominent a place in public imagination that we tend to forget that it is not the only kind that is relevant. It may be admitted that, as far as scientific knowledge is concerned, a body of suitably chosen experts may be in the best position to command all the best knowledge available—though this is of course merely shifting the difficulty to the problem of selecting the experts. What I wish to point out is that, even assuming that this problem can be readily solved, it is only a small part of the wider problem.

Today it is almost heresy to suggest that scientific knowledge is not the sum of all knowledge. But a little reflection will show that there is beyond question a body of very important but unorganized knowledge which cannot possibly be called scientific in the sense of knowledge of general rules: the knowledge of the particular circumstances of time and place. It is with respect to this that practically every individual has some advantage over all others because he possesses unique information of which beneficial use might be made, but of which use can be made only if the decisions depending on it are left to him or are made with his active coöperation.

We need to remember only how much we have to learn in any occupation after we have completed our theoretical training, how big a part of our working life we spend learning particular jobs, and how

valuable an asset in all walks of life is knowledge of people, of local conditions, and of special circumstances. To know of and put to use a machine not fully employed, or somebody's skill which could be better utilized, or to be aware of a surplus stock which can be drawn upon during an interruption of supplies, is socially quite as useful as the knowledge of better alternative techniques. And the shipper who earns his living from using otherwise empty or half-filled journeys of tramp-steamers, or the estate agent whose whole knowledge is almost exclusively one of temporary opportunities, or the *arbitrageur* who gains from local differences of commodity prices, are all performing eminently useful functions based on special knowledge of circumstances of the fleeting moment not known to others.

It is a curious fact that this sort of knowledge should today be generally regarded with a kind of contempt and that anyone who by such knowledge gains an advantage over somebody better equipped with theoretical or technical knowledge is thought to have acted almost disreputably. To gain an advantage from better knowledge of facilities of communication or transport is sometimes regarded as almost dishonest, although it is quite as important that society make use of the best opportunities in this respect as in using the latest scientific discoveries.

This prejudice has in a considerable measure affected the attitude toward commerce in general compared with that toward production. Even economists who regard themselves as definitely immune to the crude materialist fallacies of the past constantly commit the same mistake where activities directed toward the acquisition of such practical knowledge are concerned—apparently because in their scheme of things all such knowledge is supposed to be "given". The common idea now seems to be that all such knowledge should as a matter of course be readily at the command of everybody, and the reproach of irrationality levelled against the existing economic order is frequently based on the fact that it is not so available. This view disregards the fact that the method by which such knowledge can be made as widely available as possible is precisely the problem to which we have to find an answer.

If it is fashionable today to minimize the importance of the knowledge of the particular circumstances of time and place, this is closely connected with the smaller importance which is now attached to change as such. Indeed, there are few points on which the assumptions made (usually only implicitly) by the "planners" differ from those of their opponents as much as with regard to the significance and frequency of changes which will make substantial alterations of production plans necessary. Of course, if detailed economic plans could be laid down for fairly long periods in advance and then closely adhered to, so that no further economic decisions of importance would be required, the task of drawing up a comprehensive plan governing all economic activity would be much less formidable.

It is, perhaps, worth stressing that economic problems arise always and only in consequence of change. So long as things continue as before, or at least as they were expected to, there arise no new problems requiring a decision, no need to form a new plan. The belief that changes, or at least day-to-day adjustments, have become less important in modern times implies the contention that economic problems also have become less important. This belief in the decreasing importance of change is, for that reason, usually held by the same people who argue that the importance of economic considerations has been driven into the background by the growing importance of technological knowledge.

Is it true that, with the elaborate apparatus of modern production, economic decisions are required only at long intervals, as when a new factory is to be erected or a new process to be introduced? Is it true that, once a plant has been built, the rest is all more or less mechanical, determined by the character of the plant, and leaving little to be changed in adapting to the ever-changing circumstances of the moment?

The fairly widespread belief in the affirmative is not, as far as I can ascertain, borne out by the practical experience of the businessman. In a competitive industry at any rate—and such an industry alone can serve as a test—the task of keeping cost from rising requires constant struggle, absorbing a great part of the energy of the manager. How easy it is for an inefficient manager to dissipate the differentials on which profitability rests, and that it is possible, with the same technical facilities, to produce with a great variety of costs, are among the commonplaces of business experience which do not seem to be equally familiar in the study of the economist. The very strength of the desire, constantly voiced by producers and engineers, to be allowed to proceed untrammeled by considerations of money costs, is eloquent testimony to the extent to which these factors enter into their daily work.

One reason why economists are increasingly apt to forget about the constant small changes which make up the whole economic picture is probably their growing preoccupation with statistical aggregates, which show a very much greater stability than the movements of the detail. The comparative stability of the aggregates cannot, however, be accounted for—as the statisticians occasionally seem to be inclined to do—by the "law of large numbers" or the mutual compensation of random changes. The number of elements with which we have to deal is not large enough for such accidental forces to produce stability. The continuous flow of goods and services is maintained by constant deliberate adjustments, by new dispositions made every day in the light of circumstances not known the day before, by *B* stepping in at once when *A* fails to deliver. Even the large and highly mechanized plant keeps going largely because of an environment upon which it can draw for all sorts of unexpected needs; tiles for its roof, stationery for its forms, and all the thousand and one kinds of equipment in which it cannot be self-contained and which the plans for the operation of the plant require to be readily available in the market.

This is, perhaps, also the point where I should briefly mention the fact that the sort of knowledge with which I have been concerned is knowledge of the kind which by its nature cannot enter into statistics and therefore cannot be conveyed to any central authority in statistical form. The statistics which such a central authority would have to use would have to be arrived at precisely by abstracting from minor differences between the things, by lumping together, as resources of one kind, items which differ as regards location, quality, and other particulars, in a way which may be very significant for the specific decision. It follows from this that central planning based on statistical information by its nature cannot take direct account of these circumstances of time and place and that the central planner will have to find some way or other in which the decisions depending on them can be left to the "man on the spot."

If we can agree that the economic problem of society is mainly one of rapid adaptation to changes in the particular circumstances of time and place, it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes and of the resources immediately available to meet them.

We cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating *all* knowledge, issues its orders. We must solve it by some form of decentralization. But this answers only part of our problem. We need decentralization because only thus can we ensure that the knowledge of the particular circumstances of time and place will be promptly used. But the "man on the spot" cannot decide solely on the basis of his limited but intimate knowledge of the facts of his immediate surroundings. There still remains the problem of communicating to him such further information as he needs to fit his decisions into the whole pattern of changes of the larger economic system.

How much knowledge does he need to do so successfully? Which of the events which happen beyond the horizon of his immediate knowledge are of relevance to his immediate decision, and how much of them need he know?

There is hardly anything that happens anywhere in the world that *might* not have an effect on the decision he ought to make. But he need not know of these events as such, nor of *all* their effects. It does not matter for him *why* at the particular moment more screws of one size than of another are wanted, *why* paper bags are more readily available than canvas bags, or *why* skilled labor, or particular machine tools, have for the moment become more difficult to obtain. All that is significant for him is *how much more or less* difficult to procure they have become compared with other things with which he is also concerned, or how much more or less urgently wanted are the alternative things he produces or uses. It is always a question of the relative importance of the particular things with which he is concerned, and the causes which alter their relative importance are of no interest to him beyond the effect on those concrete things of his own environment.

It is in this connection that what I have called the "economic calculus" proper helps us, at least by analogy, to see how this problem can be solved, and in fact is being solved, by the price system.

Even the single controlling mind, in possession of all the data for some small, self-contained economic system, would not—every time some small adjustment in the allocation of resources had to be made—go explicitly through all the relations between ends and means which might possibly be affected. It is indeed the great contribution of the pure logic of choice that it has demonstrated conclusively that even such a single mind could solve this kind of problem only by constructing and constantly using rates of equivalence (or "values," or "marginal rates of substitution"), *i.e.,* by attaching to each kind of scarce resource a numerical index which cannot be derived from any property possessed by that particular thing, but which reflects, or in which is condensed, its significance in view of the whole means-end structure. In any small change, he will have to consider only these quantitative indices (or "values") in which all the relevant information is concentrated; and, by adjusting the quantities one by one, he can appropriately rearrange his dispositions without having to solve the whole puzzle *ab initio* or without needing at any stage to survey it at once in all its ramifications.

Fundamentally, in a system in which the knowledge of the relevant facts is dispersed among many people, prices can act to coördinate the separate actions of different people in the same way as subjective values help the individual to coördinate the parts of his plan.

It is worth contemplating for a moment a very simple and commonplace instance of the action of the price system to see what precisely it accomplishes. Assume that somewhere in the world a new opportunity for the use of some raw material, say, tin, has arisen, or that one of the sources of supply of tin has been eliminated. It does not matter for our purpose—and it is very significant that it does not matter—which of these two causes has made tin more scarce. All that the users of tin need to know is that some of the tin they used to consume is now more profitably employed elsewhere and that, in consequence, they must economize tin. There is no need for the great majority of them even to know where the more urgent need has arisen, or in favor of what other needs they ought to husband the supply. If only some of them know directly of the new demand, and switch resources over to it, and if the people who are aware of the new gap thus created in turn fill it from still other sources, the effect will rapidly spread throughout the whole economic system and influence not only all the uses of tin but also those of its substitutes and the substitutes of these substitutes, the supply of all the things made of tin, and their substitutes, and so on; and all this without the great majority of those

instrumental in bringing about these substitutions knowing anything at all about the original cause of these changes.

The whole acts as one market, not because any of its members survey the whole field, but because their limited individual fields of vision sufficiently overlap so that through many intermediaries the relevant information is communicated to all. The mere fact that there is one price for any commodity—or rather that local prices are connected in a manner determined by the cost of transport, etc.—brings about the solution which (it is just conceptually possible) might have been arrived at by one single mind possessing all the information which is in fact dispersed among all the people involved in the process.

We must look at the price system as such a mechanism for communicating information if we want to understand its real function—a function which, of course, it fulfils less perfectly as prices grow more rigid. (Even when quoted prices have become quite rigid, however, the forces which would operate through changes in price still operate to a considerable extent through changes in the other terms of the contract.) The most significant fact about this system is the economy of knowledge with which it operates, or how little the individual participants need to know in order to be able to take the right action. In abbreviated form, by a kind of symbol, only the most essential information is passed on and passed on only to those concerned. It is more than a metaphor to describe the price system as a kind of machinery for registering change, or a system of telecommunications which enables individual producers to watch merely the movement of a few pointers, as an engineer might watch the hands of a few dials, in order to adjust their activities to changes of which they may never know more than is reflected in the price movement.

Of course, these adjustments are probably never "perfect" in the sense in which the economist conceives of them in his equilibrium analysis. But I fear that our theoretical habits of approaching the problem with the assumption of more or less perfect knowledge on the part of almost everyone has made us somewhat blind to the true function of the price mechanism and led us to apply rather misleading standards in judging its efficiency. The marvel is that in a case like that of a scarcity of one raw material, without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly; *i.e.,* they move in the right direction. This is enough of a marvel even if, in a constantly changing world, not all will hit it off so perfectly that their profit rates will always be maintained at the same constant or "normal" level.

I have deliberately used the word "marvel" to shock the reader out of the complacency with which we often take the working of this mechanism for granted. I am convinced that if it were the result of deliberate human design, and if the people guided by the price changes understood that their decisions have significance far beyond their immediate aim, this mechanism would have been acclaimed as one of the greatest triumphs of the human mind.

Its misfortune is the double one that it is not the product of human design and that the people guided by it usually do not know why they are made to do what they do. But those who clamour for "conscious direction"—and who cannot believe that anything which has evolved without design (and even without our understanding it) should solve problems which we should not be able to solve consciously—should remember this: The problem is precisely how to extend the span of our utilization of resources beyond the span of the control of any one mind; and therefore, how to dispense with the need of conscious control, and how to provide inducements which will make the individuals do the desirable things without anyone having to tell them what to do.

The problem which we meet here is by no means peculiar to economics but arises in connection with nearly all truly social phenomena, with language and with most of our cultural inheritance, and constitutes really the central theoretical problem of all social science. As Alfred Whitehead has said in another connection, "It is a profoundly erroneous truism, repeated by all copy-books and by eminent people when they are making speeches, that we should cultivate the habit of thinking what we are doing. The precise opposite is the case. Civilization advances by extending the number of important operations which we can perform without thinking about them."

This is of profound significance in the social field. We make constant use of formulas, symbols, and rules whose meaning we do not understand and through the use of which we avail ourselves of the assistance of knowledge which individually we do not possess. We have developed these practices and institutions by building upon habits and institutions which have proved successful in their own sphere and which have in turn become the foundation of the civilization we have built up.

The price system is just one of those formations which man has learned to use (though he is still very far from having learned to make the best use of it) after he had stumbled upon it without understanding it. Through it not only a division of labor but also a coördinated utilization of resources based on an equally divided knowledge has become possible.

The people who like to deride any suggestion that this may be so usually distort the argument by insinuating that it asserts that by some miracle just that sort of system has spontaneously grown up which is best suited to modern civilization. It is the other way round: man has been able to develop that division of labor on which our civilization is based because he happened to stumble upon a method which made it possible. Had he not done so, he might still have developed some other, altogether different, type of civilization, something like the "state" of the termite ants, or some other altogether unimaginable type. All that we can say is that nobody has yet succeeded in designing an alternative system in which certain features of the existing one can be preserved which are dear even to those who most violently assail it—such as particularly the extent to which the individual can choose his pursuits and consequently freely use his own knowledge and skill.

It is in many ways fortunate that the dispute about the indispensability of the price system for any rational calculation in a complex society is now no longer conducted entirely between camps holding different political views. The thesis that without the price system we could not preserve a society based on such extensive division of labor as ours was greeted with a howl of derision when it was first advanced by von Mises twentyfive years ago. Today the difficulties which some still find in accepting it are no longer mainly political, and this makes for an atmosphere much more conducive to reasonable discussion. When we find Leon Trotsky arguing that "economic accounting is unthinkable without market relations"; when Professor Oscar Lange promises Professor von Mises a statue in the marble halls of the future Central Planning Board; and when Professor Abba P. Lerner rediscovers Adam Smith and emphasizes that the essential utility of the price system consists in inducing the individual, while seeking his own interest, to do what is in the general interest, the differences can indeed no longer be ascribed to political prejudice. The remaining dissent seems clearly to be due to purely intellectual, and more particularly methodological, differences.

A recent statement by Professor Joseph Schumpeter in his *Capitalism, Socialism, and Democracy* provides a clear illustration of one of the methodological differences which I have in mind. Its author is preeminent among those economists who approach economic phenomena in the light of a certain branch of positivism. To him these phenomena accordingly appear as objectively given quantities of commodities impinging directly upon each other, almost, it would seem, without any intervention of

human minds. Only against this background can I account for the following (to me startling) pronouncement. Professor Schumpeter argues that the possibility of a rational calculation in the absence of markets for the factors of production follows for the theorist "from the elementary proposition that consumers in evaluating ('demanding') consumers' goods *ipso facto* also evaluate the means of production which enter into the production of these goods."

Taken literally, this statement is simply untrue. The consumers do nothing of the kind. What Professor Schumpeter's *"ipso facto"* presumably means is that the valuation of the factors of production is implied in, or follows necessarily from, the valuation of consumers' goods. But this, too, is not correct. Implication is a logical relationship which can be meaningfully asserted only of propositions simultaneously present to one and the same mind. It is evident, however, that the values of the factors of production do not depend solely on the valuation of the consumers' goods but also on the conditions of supply of the various factors of production. Only to a mind to which all these facts were simultaneously known would the answer necessarily follow from the facts given to it. The practical problem, however, arises precisely because these facts are never so given to a single mind, and because, in consequence, it is necessary that in the solution of the problem knowledge should be used that is dispersed among many people.

The problem is thus in no way solved if we can show that all the facts, *if* they were known to a single mind (as we hypothetically assume them to be given to the observing economist), would uniquely determine the solution; instead we must show how a solution is produced by the interactions of people each of whom possesses only partial knowledge. To assume all the knowledge to be given to a single mind in the same manner in which we assume it to be given to us as the explaining economists is to assume the problem away and to disregard everything that is important and significant in the real world.

That an economist of Professor Schumpeter's standing should thus have fallen into a trap which the ambiguity of the term "datum" sets to the unwary can hardly be explained as a simple error. It suggests rather that there is something fundamentally wrong with an approach which habitually disregards an essential part of the phenomena with which we have to deal: the unavoidable imperfection of man's knowledge and the consequent need for a process by which knowledge is constantly communicated and acquired. Any approach, such as that of much of mathematical economics with its simultaneous equations, which in effect starts from the assumption that people's *knowledge* corresponds with the objective *facts* of the situation, systematically leaves out what is our main task to explain. I am far from denying that in our system equilibrium analysis has a useful function to perform. But when it comes to the point where it misleads some of our leading thinkers into believing that the situation which it describes has direct relevance to the solution of practical problems, it is high time that we remember that it does not deal with the social process at all and that it is no more than a useful preliminary to the study of the main problem.

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