

The Trend of Economic Thinking of Market and Money  
: What is the Hayek's Position on the Issues?

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1. Visions and Public Opinion in Hayek's "The Trend of Economic Thinking"

In this article I will focus on the role of worldview (*Weltanschauung*) or 'public opinion' for diffusing economic theories and thoughts in contrast to that of vision for creating them. Hayek dealt with the theme in many occasions during his academic career, but I convince that he was clearly aware of the importance of the issue since his early days because he mentioned it in "The Trend of Economic Thinking" when he made an inaugural lecture at LSE in 1933.

The aspect which I wish chiefly to emphasise is (...) the role played by purely scientific progress—the growth of our insight into the interdependence of economic phenomena—in bringing about these changes in his attitude to practical problems.(...) But, in fact, the cause of the great historical changes which I am discussing seems to me to be of a more subtle kind. It consists neither of a change in the underlying ethical valuations nor of a refutation of the validity of certain analytical propositions, but rather in a change of view regarding the relevance of that knowledge for practical problems. It was not a change of ideals nor a change of reasoning but a change of view with regard to

the applicability of such reasoning which was responsible for the characteristic features of the popular economics of today. (...) It is probably true that economic analysis has never been the product of detached intellectual curiosity about the *why* of social phenomena, but of an intense urge to reconstruct a world which gives to profound dissatisfaction. This is as true of the phylogenesis of economics as of the ontogenesis of probably every economist. As Professor Pigou has aptly remarked: "It is not wonder, but the social enthusiasm which revolts from the sordidness of mean streets and the joylessness of withered lives, that is the beginning of economic science." (Hayek, 1933a, p.18)

It should be noted that "a change of view regarding the relevance of that knowledge for practical problems," viz. "a change of view with regard to the applicability of such reasoning which was responsible for the characteristic features of the popular economics of today" is not "a change in the underlying ethical valuations of the validity of certain analytical propositions" nor "a refutation of the validity of certain analytical propositions," viz. "not a change of ideals nor a change of reasoning." Here Hayek indicated the very peculiar characteristics of social sciences, especially of economics. He had noticed and warned that the object of economics is, unlike natural sciences, social phenomena affected by subjective cognitions, actual actions and changeable passions of humans, and that economists must be aware that economics is largely affected by popular reputation or public evaluation on the analytical propositions of a positive science as well as ethical propositions of a normative science. In other words, Hayek refers to the property of economics involving in itself self-referential proposition or meta-evaluation in terms of applicability and relevancy to practical problems.

The reason why Hayek could recognize the fact is not because he wanted to gain more reputation of his economics as a prominent economist, but because he strongly concerned with the difficulty of realization of liberalism compared with socialism. But, furthermore, because of his acute perception of the peculiarity of economics that depends on influence of 'public opinion' or popularity, it would be quite difficult to take a nice balance between intellectual sincerity to the truth and concessions to popular prejudice.

[I]n our field no knowledge can be regarded as established once and for all, and that, in

fact, knowledge once gained and spread is often, not disproved, but simply lost and forgotten. (...) The result is that in economics you can never establish a truth once and for all but have always to convince every generation anew—and that you may find much more difficult when things appear to yourself no longer so simple as they once did. (Hayek, 1944, p.38)

The reason why I think that too deliberate striving for immediate usefulness is so likely to corrupt the intellectual integrity of the economist is that immediate usefulness depends almost entirely on influence, and influence is gained most easily by concessions to popular prejudice and adherence to existing political groups. I seriously believe that any such striving for popularity— at least till you have very definitely settled your own convictions, is fatal to the economist and that above anything he must have the courage to be unpopular. (ibid. p.44)

Hayek thus himself declared paradoxically that he cannot strive for “immediate usefulness” and “popularity” and “he must have the courage to be unpopular” to maintain the intellectual integrity of the economist.

Caldwell referred to the article “The Trend of Economic Thinking” and indicated that Hayek despairs over the direction of current “public opinion” that preferred increasing state intervention in the economy, and that such popular concept of planning had its origins in German historical school. Hayek touches upon a number of themes that were to engage him for the remainder of his career, but it is not a blueprint, but a manifesto or rather a starting point (Caldwell. 1988b).

I surely admit that this article contains many potential ‘visions’ that would have flourished to create important propositions and new theories later on, but here I am concerned with the article because of his attention to the idea “public opinion” related to peculiarity of economics in the time of expansion of socialism. In the next section, I will take a look at Hayek’s transformation of vision of the market. Thereafter, I will examine the role of “public opinion” in case of rapid propagation of the conventional vision of modern microeconomics formed even after Hayek’s insightful vision of the market and give some consideration into what relation between vision and worldview have in “public opinion”.

## 2. Hayek's Transformation of Vision of the Market

It is common knowledge that Hayek has changed his theoretical and methodological positions a few times during his lifetime, but there is still disagreement upon the number of times and contents of his transformations and their implications for Hayek's whole thoughts and theories (Caldwell, 1988a, 2004; Fleetwood, 1996; Foss, 1995; Hutchison, 1981; Lawson, 1994).

I have joined the arguments and presented my account on the issue (Nishibe, 2010). I contend that Hayek's turn of his market-images is the key factor of his two-time transformations in 1946 (Hayek, 1946) and 1960 (Hayek, 1960). Hayek's battle with the market socialists in socialist economic calculation debate was crucial because it enabled him to transform his vision of mechanistic market based on equilibrium into the one of market process with rivalry and discovery in the late 1940s, and further into the other one of a spontaneous order based on social rules of conduct in 1960 and thereafter. Hayek's socio-economics since 1960 results not only from his philosophical and methodological turns, but also from the change of his vision of the market that is a complex of some basic concepts in theory.

To put it more precisely as to how it developed, Hayek started as an orthodox neoclassical economist to tackle monetary business-cycle theory in view of Austrian capital and interest theory in 1920s and participated in the controversy on the feasibility of centrally planned economy in 1930s (Hayek, 1935) initiated by Mises in 1920 (Mises, 1920). He recognized through the debate with such market socialists as Taylor and Lange in 1940s that the vision of mechanical centralized market with an auctioneer of general equilibrium that underlies the whole theory of conventional economics and forms the hardcore of market socialism is a fundamentally defect to mislead the whole argument. Hayek could criticize general equilibrium theory for the first time when he has become to deal not only with allocation and exchange of scattered knowledge in a society in his famous paper in 1937 (Hayek, 1937a) but also with discovery and creation of new knowledge through the process of competition among multiple agents in the market in 1946 (Hayek, 1946). Hayek thus eventually reached a new vision of the dispersive network of economic transactions.

It is notable that the transformation involves not only methodology or theory but also vision. Here 'vision' can work as a catalyst to grasp reality and help create a new theory and methodology in science. The key concept for Hayek to break with general equilibrium and reach a new market image as his vision is rivalrous and discovery competition since 1946, not subjective and dispersive knowledge since 1937. This break is mainly caused by his struggle with Lange's trial and error method. It can be regarded as the practical application of Walrasian general equilibrium model with *tâtonnement* and 'parametric function of prices' that are supposed to work almost in the same manner with the same theoretical conditions and the ingenious strategy to make general equilibrium as orthodox pure theory of economics to endorse market socialism to be feasible in the debate.

It is conceivable that Hayek's transformation has taken place in a sequence of 1) vision, 2) theory, and 3) methodology. To put it in general, ontogenesis of a theory would be as follows. Vision gradually turns into theory. Once theory is established, methodology is abstracted from theory as meta-theory and it fundamentally determines or constrains the basic structure of theory. It is often observed that a shift in methodology is not the cause, but the result of change of theoretical endeavor as substantive scientific activities grappling with reality. Methodology does not transform itself nor automatically create a new theory.

Vision in substantive economics is no less important than methodology, particularly in order to discover a new finding, create a new framework and improve scientific knowledge of reality. Vision offers a metaphor, an analogy or an image to activate *abduction* different from deduction and induction, which consists in a cognitive movement from surface phenomena (event / action) in empirical domain to some deeper mechanisms, structures, rules, tendencies, power or relations. So it is recognized that vision is necessary for scientific hypothetical reasoning that enables creation of new theories or conceptions. Once vision transforms, it requires a change of methodology in order to present an integrative and consistent basis of a new theory so that it can formally systemize itself. The vision of a theory as the frame of reference to key concepts in economics, even though they cannot be expressed in explicit manner in the first place, are not less important than methodology in order for economics to explore the unknown reality of our socio-economic world.

Hayek's case of transformation exemplifies the propositions on the relation of vision, theory

and methodology. He had experienced his philosophical turns through I-III, however, the transformation in methodology had not taken place by itself. Such particular 'hardcore' concepts as equilibrium, competition and knowledge have gradually changed the prevailing vision of the market that was to be replaced by a new one at some threshold point. The vision of the market is a complex constituted by those concepts to support a total structure of a theory, so its change is potentially able to overturn the economic theory as a whole. Methodological shifts followed these changes in order to build the foundations.

Hayek's market-image of 'a rivalrous and dispersive discovery procedure for knowledge' should be a vision for establishing a new theory of the market as a self-organizing complex system or a 'spontaneous order' that is the basic idea of Hayek III after 1960s, whilst Hayek himself had not accomplished it. Hayek's vision can still help us create more articulate theory of the market in reality.

Now I would like to explain the main reason why I must pay special attention to the rivalry of multiple independent ends and discovery of dispersive and unknown knowledge in Hayek's market-image depicted in a series of his articles after 1946 (Hayek, 1946, 1947, 1968). This is because modern extensive version of neoclassical economics with development of informational economics, and even part of Austrians schools tend to take Hayek's "Economics and Knowledge" (Hayek, 193a) as an epoch-making breakthrough to a new view of the market as 'the telecommunications system' and especially to informational economics. It is plausibly told that Hurwicz (Hurwicz, 1960, 1971), by inheriting Hayek's vision of the market, pioneered the notions of incentive compatibility and informational efficiency and developed the theory of mechanism design.

But I doubt that such informational development of economics is largely based on the idea of a concentrated market with an auctioneer or the parametric function of prices and it has not built in Hayek's vision of the dispersive market. This is why I consider that interpreting Hayek as the founder of informational economics is lack of understanding the essence of his position on the issue of the market and it is utterly misleading. We had better think that this is a battle among many schools of economics not for scientific truth and validity but for justification for the throne and public popularity. The notion of 'vision' is not sufficient to understand the dynamic process of this kind of phylogenesis of economics. We would come

back to the point once again when we come up against 'worldview' in the next section.

### 3. Modern Worldview of the Market and its Error

On Hayek's transformations of vision of the market, we have thus focused on the crucial role of 'vision' of an economist as a creator of new theories because we were interested in the process of innovation of economics. Here, in order to consider how new theories of economics can diffuse among people and give an influence on public opinion and economic policy, we would like to shed light on the other side of the thing, i.e., the important role of 'worldview' (Weltanschauung) of the intellectuals as propagators of new theories.

Hayek has paid attention to the peculiar role of the intellectuals. A strong belief prevailed that the influence of the intellectuals on politics is negligible, but they in fact exercised a great power of influence by shaping 'public opinion' when they performed the role as intermediary in the spreading of ideas. In this respect, Hayek, assuming that socialism won the victory over liberalism in the year of 1949 after WWII, endeavored to understand the reason why so many of the intellectuals are inclined toward socialism and write out a prescription (Hayek, 1949). His conclusion is that "the main lesson which the true liberal must learn from the success of the socialists is that it was their courage to be Utopian which gained them the support of the intellectuals and therefore an influence on public opinion which is daily making possible what only recently seemed utterly remote."(ibid., p.237) He encourages to create "a new liberal program which appeals to the imagination, (...) a liberal Utopia, a program which seems neither a mere defense of things as they are nor a diluted kind of socialism, but truly liberal radicalism which does not spare the susceptibilities of the mighty" (ibid.)

From our viewpoint of the present time in the 21st century when capitalism has gained a great triumph over socialism, everything seems diametric opposite in those days. At present, disillusion of a socialist Utopia prevailed and still remain strong. Market fundamentalism and globalization, instead of socialism and planning, has gained popularity from many of the intellectuals. Accordingly, we have to think of the modern trend of economic thinking as diffusion of the worldview of the market described in popular neoclassical microeconomics that is fundamentally different from Hayek's own market-images in many ways.

The modern trend of economic thinking is probably composed of the following three propositions with respect to the market.

- (1) The market is the mechanism for efficiently allocating scarce resources to economic agents by free contract and transaction under the given condition of property relation of goods and services at the initial point in time unless we can assume a paradise where limitless kinds and amounts of goods exist and satisfy all the wants of people.
- (2) In order for the market to work well, we endeavor to fulfill the condition for 'perfect competition' as much as possible by deregulating all industries, clarifying property rights, minimizing governments and increasing the number of and decreasing the size of agents.
- (3) If the perfect competition condition is fulfilled so that the parametric function of prices can work, the efficient market mechanism is universally and fully usable for formation of socio-economic order and mutual coordination of agents' actions.

We name each proposition as follows: (1) 'the Definition of the Market by Scarcity', (2) 'the Condition for Perfect Competition', and (3) 'the Proposition on Market Universality.' Such parametric function or signaling function of prices requires satisfaction of such conditions for perfect competition as: (a) one-price to one-good law holds because prices in a market are transmitted instantly and with no cost to each economic agent; (b) each economic agent behaves as a price taker because a large number of small sized agents are assumed; (c) there is freedom for firms of entry to and exit from industries and no institutional obstacles for that; and (d) all goods are homogeneous in quality.

In short, the trend of economic thinking composed of (1)~(3) defines and explains the market as an ideal type of pure price mechanism precisely in the same way as orthodox microeconomics in modern economics does. It regards the market as a highly efficient mechanistic tool that can function more smoothly if we make it approach the condition of perfect competition as close as possible. It is notable that perfect competition that enables parametric function of prices to be workable could be regarded as a normative criterion for evaluating the condition of the market economy in order to determine whether to execute anti-monopolistic competition policy and deregulation. Since the intellectuals as market fundamentalists stick to the worldview that the 'free' market is always desirable because it



should function well, while forgetting such highly hypothetical conditions as (2) 'the Condition for Perfect Competition', and (3) 'the Proposition on Market Universality that specialists and economists never forget, they can feel strong motivations to advocate those policies by depending upon such a worldview of the market.

When Hayek talks about his own profession as an economist to his students, because he is fully aware of the peculiar characteristics of economics apart from natural sciences, his remarks sound quite pessimistic tones and describe an economist full of sorrow as follows.

The progress of the natural sciences often leads to unbounded confidence in the future prospects of the human race, and provides the natural scientist with the certainty that any important contribution to knowledge which he makes will be used to improve the lot of men. The economist's lot, however, is to study a field in which, almost more than any other, human folly displays itself. The scientist has no doubt that the world is moving on to better and finer things, that the progress he makes today will tomorrow be recognized and used. (...) I want to consider the more serious cause for sorrow to the economist, the fact that he cannot trust that the progress of his knowledge will necessarily be followed by a more intelligent handling of social affairs, or even that we shall advance in this field at all and there will not be retrograde movements. The economist know that a single error in his field may do more harm than almost all the sciences taken together can do good---even more, that a mistake in the choice of a social order, quite apart from the immediate effect, may profoundly affect the prospects for generations. (Hayek, 1944, pp.35-36)

The reason why Hayek was so pessimistic to be an economist is concerned with the nature of knowledge created and obtained in economics. While the discovery and accumulation of new knowledge in natural sciences directly means progress and prosperity of human civilization, on the other side, more knowledge cannot necessarily ensure advance but might lead to retrograde movements in economics. A single error in the choice of a social order may affect the prospects for generations. It can thus do more harm than almost all sciences can do. This is why economists cannot be confident and hopeful, but rather be fearful, to the future.

This connotation is completely different from that of 'dismal science' that Carlyle put to

economics as a nickname when he describe the character of the correlation between population and starvation in Malthus' population principle as "dismal." In case of this, it is the expression only for a particular type of propositions and prospects with misery in economics. But such pessimism and fear as Hayek attributes to economics arises from the general character of economics, i.e. its inclusion of self-evaluation of scientific statements and proposition of social affairs in economics and its validity and applicability depending on public perception or popularity of the theory. It is evident that Hayek's sorrow and fear of being an economist is much deeper. We should to be fully aware of the unique nature of economics and social sciences in general.

#### 4. Hayek's Position of Vision of the Market

It should be reconfirmed that Hayek's vision of the market after 1946 is largely different from the conventional vision of the market in modern microeconomics.

Hayek has become to made clear that the knowledge to be discovered through competition in the market is individual's "capacity to find out particular circumstances" that cannot be regarded as 'given data'. Hayek has already abandoned the view that a market economy accomplishes efficiency as the result of competition as general equilibrium theory claims. We require 'competition as a discovery procedure' precisely because we do not know data in the economy nor the results of competition, and competition in the market is the only available procedure to find out them by utilizing guidance of prices. The results of a discovery procedure are unpredictable in respect of particular outcomes, neither the attainment of efficient allocation of scarce resources nor efficient utilization of knowledge in a state of equilibrium. What we can expect from competition is to improve the chances of unknown people and to form the general kind of pattern, or the abstract character of the self-organizing order. (Hayek, 1968)

Hayek argues that we must evade the confusion between 'order' that the market produces and 'economy' in Hayek's term that correspond to a single organization or arrangement in which someone deliberately allocates resources to a unitary order of ends. Spontaneous order produced by the market is completely different from the 'economy' because all the members of such an economy must be guided in their actions by the unitary hierarchy of

ends that it serves. The spontaneous order of the market, or the catallaxy, cannot legitimately be said to *have* particular ends, it is also not possible to express the value of the results as a sum of its particular individual products. The concept of an 'order' is preferable to that of equilibrium for the discussion of problems of economic policy. While an economic equilibrium never really exists, there is some justification for asserting that the kind of order of which our theory describes an ideal type, is approached in a high degree. This competitive game is not a zero-sum game, but a plus-sum game where the income of each member is determined by partly of skill and partly of chance.

It is quite clear that, while the purpose of "competitive order" is to make competition that of "ordered competition" is to restrict the effectiveness of competition. Therefore, any government policy in order to make competition as effective and beneficent as possible by adopting competition, the market and prices as its ordering principle, rather than absence of state activity, is necessary.

The interpretation of the fundamental principle of liberalism as absence of state activity rather than as a policy which deliberately adopts competition, the market, and prices as its ordering principle and uses the legal framework enforced by the state in order to make competition as effective and beneficial as possible is as much responsible for the decline of competition as the active support which governments have given directly and indirectly to the growth of monopoly. It is the first general thesis which we shall have to consider that competition can be made more effective and more beneficent by certain activities of government than it would be without them. (Hayek, 1947)"

Hayek also admits that we have to consider which services as sanitary and health measures the government should provide outside the market and what kind of institutional design of the desirable market economy is necessary, which include the market policy, the monetary and financial policies, the law of property and contract, of corporations and associations, including trade-unions, the problems of monopolies, taxation, international trade, patent for inventions, copyright, trade-marks, labour, trade-union policies. We thus observed that Hayek's position on the issue of the vision of the market has gradually departed from the general equilibrium theory and reached the point where he recognized the comprehensive institutional design of the competitive order of market economy supplemented by such

necessary government policies as we have seen above.

## 5. Hayek's Position of Vision of the Money

During the course of Hayek's transformation of his vision of the market, he has also shifted his vision of money: a) monetary theory of business cycle and neutral theory of money (Hayek, 1931, 1933b), b) fixed exchange rate (Hayek, 1937b), c) commodity reserve money (Hayek 1943), d) competing currencies (Hayek, 1976).

Hayek's notion of neutrality of money was defined as the equality of the natural rate of interest and the money rate of interest. The natural rate is the equilibrium rate to ensure intertemporal equilibrium of consumption and production, viz. the equality of saving and investment. Since deviation from neutrality of money as disequilibrium between the natural rate of interest and the money rate of interest that is initiated by low money rate of interest and expansion of bank lending by credit creation causes forced saving and cyclical fluctuation, a neutral money economy is free from business cycles. Accordingly, making money neutral can prevent from booms and depressions. (Hayek, 1931. 1933b) After the breakdown of gold standard of international monetary system, he proposed the commodity reserve money backed by stored commodities that is redeemable to a constant combination of commodities, instead of bullion, for stabilizing value of money (Hayek, 1943).

The free market orders periodically suffer from fluctuations, in particular, depression and unemployment in the course of business cycles. Hayek, in order to overcome such shortcomings of the capitalistic market economy, proposed that government or the central bank should be deprived of its monopoly of the issue of money in order to let private banks and enterprises to freely issue their peculiar moneys competing each other so that the public can choose good moneys among them (Hayek, 1976). Hayek believes that such liberalization of money issue will enable to neutralize money and stabilize the value of money so as to prevent excessive inflation and deflation as the main defects of the present market economy. This is because discrete monetary and fiscal policies of the government and central bank, huge deficit of finance can be prohibited or restricted. Hayek has tackled the fundamental problems of the market and money and presented a new evolutionalist institutional design of money by a gardener, different from a constructivist one by a planner that he continues to

criticize. Even though Hayek's proposition of denationalization of money is somewhat astonishing to the people with the usual worldview, it is conceivable that his proposal for institutional design of the market and money and his visions of the market and money are theoretically consistent because the platform institutions of both the market and money, in view of media design, not mechanism design, are thought to be self-organizing and evolutionary spontaneous order via the principles of variation (innovation), transmission (leaning knowledge) and selection (competition)

## 6. The Relation of Vision and Worldview

What Hayek has been, even if unknowingly or tacitly, concerned in many writings with both vision that economists use to create economics and worldview that the intellectuals use to diffuse it must indicate that he had realized the dual aspects of economics as investigation and persuasion since his early days just as Keynes had.

I shall not argue that the economist has no influence. On the contrary, I agree with Lord Keynes that "the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else." The only qualification I want to add, and with which Lord Keynes would probably agree, is that economists have this great influence only in the long run and only indirectly, and that when their ideas begin to have effect, they have usually changed their form to such an extent that their fathers can scarcely recognize them. (Hayek, 1944, pp.36-37)

The propositions in the passage are true of both Keynes and Hayek especially after their death. Whether we see vision and worldview them as the source of sorrow/ fear or that of joy/ hope might depend on how we conceive and visualize evolution of both economy and economics (Nishibe, 2006).

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