Competition As A Discovery Procedure (F.A. Hayek, 1968)

Main Points Summary

Nota Bene: The following is a paraphrase of Hayek's lecture, prepared by Naomi Beck & (naturally) coloured by the author's understanding. You are advised to read the original.

Definition:

Competition is a procedure for discovering facts, which, if the procedure did not exist, would remain unknown or would not be used (p. 9).

In other words, competition is important only when we don't know the circumstances that determine the behaviour of the players, i.e. it is important only when its outcomes are unpredictable and on the whole different from those that anyone would have been able to consciously strive for.

First Corollary:

The validity of the theory of competition can never be empirically verified for those cases in which it is of interest (p. 10).

The reason for this claim lies in Hayek's postulate that we cannot know in advance what we wish to discover with the help of competition. This is why it is absurd to give the label "perfect competition" to a state in which all the players know all the facts (full information), because in this situation the opportunity for competition no longer exists. Similarly, it is an error to designate the outcome of competition as "equilibrium," because this state of affairs presupposes that the relevant facts have already been discovered and therefore that the process of competition has come to an end. In short, it is unfair to judge the performance of the market "top down," namely by comparing it with an ideal situation of full information that we are unable to attain anyway (for instance, assuming the existence of an omniscient central planning entity able to collect and process all the relevant facts).

This view of economics relies on the approach known as methodological individualism. It favours microeconomic analysis over macroeconomics because of the claim that what causes economic regularities is in the "fine structure," viz. the non-immediately observable variables (e.g. people's knowledge, skills, preferences, etc. or variables that they cannot report to a government agency in any coherent manner). In contrast, the macro structure, which is made of aggregates and averages, gives the "obscure image of reality we call statistics" (p. 12). It is obscure because its variables (e.g. national income) play no role in the process of their own determination, and as a result they don't measure anything meaningful. ("…all the collective supply and demand curves that we use so happily are not really data, but rather outcomes of the constantly ongoing process of competition" p. 16). As a result, the predictions that macroeconomic analysis offers are pointless because they don't measure what really causes the economic regularities that we notice on the macro scale, and there is no way of telling when they apply and when they don't. The only predictions that the science of economics allows are so-called "pattern predictions," viz. general predictions of a type of structure or abstract order (e.g. competition is the best method for discovery and efficient use of resources) and not predictions of specific outcomes. Thus, the best empirical proof we can give for the benefits of competition is that societies who make use of it are more advanced than those who don't.

Second Corollary:

It is precisely through the disappointment of expectations that a high degree of agreement of expectations is brought about (p. 15).

The spontaneous order of the market is very different from "economy." In the strong sense (or the original Greek sense of "household management"), economy means an arrangement in which someone/some agency uses means in the service of a uniform hierarchy of ends. But the spontaneous order of the market, or "catallaxy" (from the Greek Katallasso = to change/exchange), does not guarantee the satisfaction of what people might regard as the more important needs. In other words, the market doesn't serve a particular ranking of priorities. Instead, it contributes to the realisation of a number of individual objectives, which are diverse and even clash, through the use of knowledge dispersed among all participants. The advantage of this structure is that it "increases the prospects of unspecified persons" (i.e. everybody) to achieve their goals, without favouring any particular people/objectives. The cost is that some objectives are bound to remain unrealised. Though everybody will benefit from competition (because, for instance, those who produce more efficiently will do so and provide an abundance of cheaper products) not everybody will benefit from competition in an equal manner (because the more efficient producers will extract larger profits and take the market share of less efficient producers). This situation is analogous to playing a non-zero-sum game based partly on skill and partly on chance. The rules of the game will increase both opportunities and payoffs but they will not determining ex ante to who specifically the larger share should fall or which activity should take precedence over others.

Conclusion:

Social justice… [has] only one meaning: protecting some groups of people from having to descend from the absolute or relative lifestyle they have heretofore enjoyed (p. 17).

The basic misunderstanding that the beneficial effects of a self-organising market come about by frustrating certain expectations and intentions leads to a demand for more equal distribution. Yet, only the negative feedback mechanism of the market, which tells people that what they have done so far no longer fits the circumstances, can help us maintain a certain level of welfare in a constantly changing world, let alone improve it. This adaptation process happens without taking into account merit. In other words, it isn't fair in the sense that those who deserve more get more. The market order is a form of impersonal coercion, which is blind to specific needs, and which causes individuals to change their behaviour or forces them to imitate improvements, and that is why people tend to rebel against it.