

“The Sources of Order and Disorder”: On *Knowledge and Coordination*

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Introduction

The twentieth century debate over the desirability of competing sources of order—broadly, *authority* or *liberty*—ended in a decisive victory for liberty. In *Knowledge and Coordination: A Liberal Interpretation*, Daniel Klein explains how social order is not built by central authorities. Rather, it emerges as the unintended consequence of people trucking, bartering, buying, and selling in an environment that admits maximum flexibility for entrepreneurs confronting novel situations. In such an environment, discovery is coordination-improving and wealth-creating. Introducing violence and substituting authority for exchange alters the discovery process and pushes entrepreneurial energies in directions that may create wealth subject to institutional constraints but that would have created even more wealth were it not for institutional hurdles.

Sowell (2007: 96) offers two different approaches to reason and rationality as they relate to social processes, noting that “the two visions differ fundamentally as to the sources of human survival and progress”:

According to the unconstrained vision, the patterned behavior of society is successful, just, and progressive insofar as it reflects the articulated rationality of man in general and of the most intellectually and morally advanced people in particular. Order—and especially a just and progressive order—is the result of design, backed by the commitment of people dedicated to the general welfare.

In the constrained vision, where man—individually and collectively—lacks both the intellectual and moral prerequisites for such deliberate, comprehensive planning, order evolves historically without design, and more effectively than when it is designed.

Knowledge and Coordination is very much an exercise in the constrained vision. In it, Klein contributes to and extends the intellectual project originating in the work of Adam Smith and continuing through the work of Friedrich Hayek and Milton Friedman. Klein is enthusiastic about liberty because, quite simply, it generates an order consistent with flourishing even in the face of limited knowledge, limited moral fortitude, and conflicting goals, plans, and ideas about what constitutes a good life.

Evaluating social order, however, is about more than searching over a range of outcomes emerging from different patterns of incentives, choosing a desired outcome, and then arranging incentives accordingly. As Sowell (2007) notes, our moral and intellectual limitations—the dispersal of social knowledge across billions of minds—suggest that we should be more interested in the process characteristics of political, social, and economic institutions.

Discovery is one of the most important of the process characteristics in which we should be interested. Klein helpfully includes a glossary in which he defines many of his terms, and he defines “discovery” as “Coming to new knowledge. The new knowledge may be more a matter of a new interpretation than a matter of new pieces of information.” Competitive markets in which entrepreneurs flourish generate wealth-generating discovery by weeding out what doesn’t work and by retaining what does. In an interventionist economy, some discovery can be *superfluous* in that people are discovering “new knowledge” about how to overcome regulatory obstacles. This consumes resources that could otherwise be used for other pursuits.

Baumol (1990) wrote that entrepreneurship can be productive, unproductive, and destructive. We can say the same about discovery: some discoveries are productive. Others are unproductive, or wasteful. Under the right conditions, discovery can also be destructive. In *Knowledge and Coordination*, Klein follows Adam Smith in defending the classical liberal order. While it is true that free markets are allocatively efficient under the right conditions, it is much more important that free markets are “adaptively efficient,” to borrow from North (1990, 2005). In the liberal order explained and defended by Adam Smith, Friedrich Hayek, and others, entrepreneurs are free to discover. They are free to try, to succeed, and to fail. This liberty helps generate the standards of living we enjoy today (McCloskey 2006, 2010).

Discovery, Prosperity, and Politics: Regulation as Superfluous Discovery

Borrowing from Hayek (1973), Kirzner (1985), and Ikeda (1997), Benson (2011) notes that a regulator’s “deliberately designed rules are not able

to completely dictate the targeted behavior because knowledge is incomplete for the rule maker.” He continues: “The knowledge problem suggests, among other things, that there are too many uncontrolled margins and unanticipated responses for a rule designer to recognize and anticipate, in part because the changes create new set of opportunities that have not previously been available.” Again elaborating on Hayek, Kirzner, and Ikeda, Benson notes that a regulatory environment prevents discovery outright in some cases and leads to what Kirzner called “superfluous discovery”—whereby entrepreneurs discover ways to adapt to or circumvent regulations—in others (Benson 2011: 196-97).

The development of public choice theory showed how discovery can also be destructive (cf. Baumol 1990).² The prospect of violence as a way of securing cooperation alters the relative returns to wealth-creating and wealth-transferring (ultimately, wealth-destroying) activities. The knowledge problems explained by Benson suggest that there are margins on which regulators cannot specify in advance “appropriate” responses to either political or commercial stimuli.

In its most benign form, this generates superfluous discovery as firms come up with ways to provide the regulated service as they see fit while obeying the letter of the law. A Chick-fil-A restaurant in Birmingham, Alabama, launched a curbside service drive-up tent after its initial design featuring a drive-through was rejected by local regulators.³ The development of new regulatory infrastructure also creates opportunities for firms and organizations to discover ways to seek rents. As McChesney (1997) discusses, the development of a complex legal-regulatory infrastructure also creates opportunities for politicians to devise ways to *extract* rents by threatening action.

These might be the prices we pay for political institutions that correct market failure; in light of Klein, however, it seems that the regulatory state is itself an exercise in unnecessary discovery as there are robust mechanisms by which markets deal with their own failures. Klein argues that we should extend the range of freedom and entrepreneurial experimentation to the regulatory environment, as well. He writes (2012: 8):

What the regulators neglect is that the very hazard or problem posited would generate awareness and opportunity for new practices and institutions, which reassert the primacy of coincidence of interest. Just as skaters will spontaneously adjust to an aberration on the floor of the [skating] rink, such as an obstruction, people in the market creatively adjust to aberrations from coincidence of interest. The aberrations create

new opportunities for mutual gains, opportunities that summon our entrepreneurial propensities to resolve or avoid the initial aberration.

In response to market failure arguments for intervention, Klein offers a “Hayekian proposal: proprietary governance” (Klein 2012: 169ff). Many of the conflicts that induce us to turn to regulatory intervention are the result of the fact that so many valuable assets are in a sense *created* commons: they are owned and operated by the government, and disputes about their use are settled through political rather than commercial channels.

What kind of discovery is likely to take place in this setting? Since these resources are owned and operated by the state, it is likely to be a pure accident if they are allocated to their highest-value uses. Instead of using the resources in such a way as to serve the customers who value them most highly, they will be used in such a way as to serve the political constituents with the most clout. In response, we can expect entrepreneurs to invest more resources in developing clout rather than in developing new and better ways to serve their customers. The inevitable conflicts that arise from an environment in which people have incomplete information or in which people make mistakes—or even in which people commit acts of outright malice—are opportunities for entrepreneurial discovery that are short-circuited by political control.⁴

Conclusion: Why Not Liberty?⁵

Knowledge and Coordination is a contribution to a tradition in political economy that stresses the importance of discovery and the necessity of what Adam Smith called “the obvious and simple system of natural liberty.” Klein is working very much in a rich intellectual tradition that follows Adam Smith through Friedrich Hayek and Milton Friedman. Klein lets his libertarian colors show in his conclusion, and he is specific as to his interpretation of Smith’s project, writing that “Smith wanted to advance, as a social operating system, the equal-equal relationship, parsed according to the principles of voluntarism, and to minimize the superior-inferior relationship, parsed according to the contravention of those principles by institutionalized authority” (Klein 2012: 245).

To the extent that Smith’s preferred “social operating system” is conducive to human flourishing—and an ever-mounting body of evidence suggests that it is—it is a worthy goal. At this point, however, we do not yet understand why it seems that liberty is constantly in the dock, seeking to prove itself against a battery of charges from those who place their faith in power. This is changing, however, as studies by Caplan (2007), Pincione and Teson (2006), and Leighton and Lopez (2013) help us understand why wealth-

reducing policies persist and as studies by (again, for example) Pennington (2011) and Huemer (2012) offer us exercises in *Robust Political Economy* and robust political philosophy that defend the liberal order. The Grand Unification Theory of the Social Sciences continues to elude us, but if such a potentiality is out there, *Knowledge and Coordination* brings us closer to its realization.

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Notes

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² See Leighton and Lopez (2013) for a summary of public choice theory and its development.

³ See Diel (2013) for discussion.

⁴ For a perspective on the spontaneous evolution of legal institutions, see Hasnas (1996).

⁵ Cf. Cohen (2009).

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