

Equality before the Law and its Role for Transition to Capitalism: Thoughts from Hayekian Epistemology and Social Theory

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Abstract

With respect to the work of Friedrich August von Hayek, this article points out the importance of the principle of equality of law for economic performance. The systematic place of equality before the law in Hayek's work is to be found in his differentiation between two fundamental principles of order in society. The theoretical relation between the order of a society and its economic performance is expressed empirically. Countries with a higher realization of the rule of law regularly have a higher income per capita. With respect to transitional countries, it therefore could be stated that the success of transition depends also on the grade of the realization of the principle of equality before the law and of the rule of law in those countries.

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I. Introduction

1. *Outline of the Problem*

This essay examines the role of the traditional liberal value of equality before the law for the transformation of former socialistic economies from the perspective of Hayekian social theory with reference to the Hayekian epistemology.

First, we will look at the idea of equality before the law. In Section II an outline of the Hayekian epistemology and an explanation of the relation of his epistemology to his social theory will then make clear the role of *knowledge* in Hayekian thinking, and with such an understanding we can understand the role of *order* in

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society. Then we will be able to examine the role of order in society in general as well as the differences between kinds of order in society with respect to the principle of equality before the law in Section III. From the Hayekian and knowledge-oriented point of view, we can show that the specific kind of order that follows the principle of equality before the law possesses economically superior qualities against orders of inequality before the law. In Section IV we can then apply these findings to the transformation of economic systems. Section V tries to support the economic relevance of the theoretical considerations empirically, while the conclusion in Section VI offers a recommendation concerning the success of transitional countries.

2. *The Basic Idea of Equality Before the Law*

The idea of equality before the law is often associated with the late political philosophers of the enlightenment era. Like the ideas of democracy, science, critical rationalism and private property, so the ideas of equality before the law and of the rule of law embody an important part of the intellectual and cultural foundation of the west. As the historian Phillippe Nemo explains, all these ideas are a product of the “morphogenesis of the west,” which consisted of cultural inventions of the old Greeks, the humanism of the old Romans, and the eschatological revolutions of the Bible (Nemo, 2004). The Greeks have realized that man is not only dependent on the physical order of nature, the *physis*, but that man is also dependent on the order of human conventions, to the *nomos* (Hayek, 1973, p.20, 94ff).

Aristotle stated in the third part of his *Politics* (paragraph 16):
And the rule of law is preferable to that of any individual. On the same principle, even if it be better for certain individuals to govern, they should be made only guardians and ministers for the law. ... He who bids the law rule, may be deemed to bid god and reason alone rule, but he who bids man rule adds an element of the beast; for desire is a wild beast, and passion perverts the minds of rulers, even when they are the best of men.

The ideas that arose in ancient Greek society were discussed and formulated more precisely later by the later English philosophers in the 18th century. Most notably, representatives of the Scottish moral

philosophy, such as David Hume, John Locke, Adam Smith, or Adam Ferguson, referred again to basic liberal ideas like equality before the law.

II. Hayekian Perspective

1. *Hayek and Equality*

In his social theory, Hayek refers unequivocally to the tradition of the Scottish moral philosophers (Hayek, 1973, p.20, 22). Furthermore, it is Hayek who provides an epistemological framework that can be used to explain the role of the old idea of equality before the law for economic development. The importance of equality before the law in Hayek's thinking becomes obvious in his main political work, *The Constitution of Liberty*, when he states, "The great aim of the struggle for liberty has been Equality before the Law" (Hayek, 1960, p.85).

With reference to the example that even Hitler acted in accordance with constitutional rules, he explains that the idea of the "rule of law" means more than that politicians must follow rules. The principle of rule of law can safeguard equality before the law only under the condition that it is understood as the principle that general and abstract law should be the *only* way of exercising power: "The Rule of Law thus implies limits to the scope of legislation: it restricts it to the kind of general rules known as formal law and excludes legislation either directly aimed at particular people or at enabling anybody to use the coercive power of the state for the purpose of such discrimination" (Hayek, 1944, p.92).

Hayek supported limited government and equality before the law because he recognized that these prevent corruption and lay the basis for the emergence of a spontaneous market order and for a fruitful economic process. To reveal the relation between the realization of equality before the law and the creation of wealth in Hayek's reasoning, looking at his epistemological ideas will be advantageous.

2. *Hayekian Epistemology*

In his 1952 epistemological work, *The Sensory Order*, Hayek describes the human mind as an *instrument of classification*. The only way for human beings to receive information from their environment is through the process of classification. Thus, according to Hayek, all we know about the world is known only in the form of how our nervous system classifies incoming impulses (Hayek, 1952, p.55ff).

The objects of the physical world are not tangible to our mind; rather, our mind consists merely of a system of classifications of objects of the physical world. It follows that the only way in which the world can affect our mind is that it changes or refines these classes. Perception is thus always an interpretation, the placing of something into one or several classes of objects. But referring to classes of “something” necessarily means to use abstractions of “something.” All sensory perception is therefore, in a sense, “abstract” (Hayek, 1952, p.142ff).

Hayek also applies his findings to his social theory, as we can see in the beginning of his main work, *Law, Legislation and Liberty*, when he argues,

Thus considered, abstraction is not something which the mind produces of logic from its perception of reality, but rather a property of the categories with which it operates – not a product of the mind but rather what constitutes the mind. We never act, and could never act, in full consideration of all the facts of a particular situation, but always by singling out as relevant only some aspects of it (Hayek, 1973, p.30).

3. Relation of Epistemology and Social Theory

Hayek’s epistemological realization of the inevitable abstractness and restrictedness of human perception had a strong influence on his social theory. This becomes obvious when he discusses the different kinds of orders in society: “The chief difficulty is that the order of social events can generally not be perceived by our senses but can only be traced by our intellect. It is, as we shall say, an abstract and not a concrete order” (Hayek, 1963, p.457ff). Here he refers to the limited capacity of the single human mind to realize specific features of the real world, and it is for that epistemological limitation that human beings are dependent on orderly structures in society!

Order in society is brought forth by rules. Thus, Hayek describes the solution for the epistemological problem when he relates the problem of the limitations of the human mind to the rules: “The only manner in which we can in fact give our life some order is to adopt certain abstract rules or principles for guidance, and then strictly adhere to these rules we have adopted in our dealings with the new situations as they arise” (Hayek, 1967, p.90). The lion’s share of the

rules that actually govern our behavior in society can be seen as a heritage from cultural and biological evolution.

4. *The Role of Knowledge*

In *The Sensory Order*, Hayek gives reference to his profound experience in thinking about epistemological problems. The importance of knowledge for his social theory is also evident. I only want to mention here his reasoning on cultural evolution, the role of rules as cognitive tools to master environmental problems, the reasons for his rejection of central planning, and his view of the market as an instrument to discover and utilize dispersed knowledge.

In his important political contribution *The Road to Serfdom*, Hayek makes an argument against central planning with reference to the restrictions of human knowledge:

If individuals are to be able to use their knowledge effectively in making plans, they must be able to predict actions of the state which may affect these plans. But if the actions of the state are to be predictable, they must be determined by rules fixed independently of the concrete circumstances which can be neither foreseen nor taken into account beforehand: and the particular effects of such actions will be unpredictable (Hayek, 1944, p.84).

Continuing, he states that if, on the other hand, the state were to direct the individual's actions so as to achieve particular ends, its action would have to be decided on the basis of the full circumstances of the moment and would, therefore, be unpredictable. Hayek concludes: "Hence the familiar fact that the more the state 'plans,' the more difficult planning becomes for the individual" (Hayek, 1944, p.84).

Since at least economic success rests on the possibilities of making economic plans, the relationships between knowledge, order in society, and economic success in Hayek's work become clear. It could be said that from a Hayekian point of view that the fulfillment of equality before the law in a society plays an economic role, which could be explained with reference to his epistemological reasoning about the use of knowledge in society.

III. The Role of Order in Society

1. *Order in Society*

To understand the economic importance of equality before the law and its relevance for transformation economies, we want to understand, first, the differences between two different kinds of order in society and, second, the epistemological relevance of these differences.

In some sense it could be said that social theory begins with the discovery that there exist orderly structures, which are the product of the action of many men, even if they are not necessarily the result of human design. Here the analysis of the “unintended social consequences of individual behavior” by Adam Ferguson or the concept of the “invisible hand” of Adam Smith (Hayek, 1973, p.20) could be mentioned as examples. Hayek provides a definition of the term that is abstractly formulated and, therefore, largely free from negative connotations:

By ‘order’ we shall throughout describe a state of affairs in which a multiplicity of elements of various kinds are so related to each other that we may learn from our acquaintance with some spatial or temporal part of the whole to form correct expectations concerning the rest, or at least expectations which have a good chance of proving correct (Hayek, 1973, p.36).

This specific and very general understanding of “order” is relatively inaccessible for ambiguous valuations until it is applied to social applications, such as in Hayek’s definition of a society: “We call a multitude of men a society when their activities are mutually adjusted to one another....Their relations, in other words, show a certain order” (Hayek, 1963, p.457).

Now we are going to examine the basic principles of social organization, first with respect to the realization of equality before the law in each of these principles, and second with respect to their characteristics from an epistemological point of view.

2. *Oikonomia*

The first (archetypical) kind of social order in Hayek’s thinking is the organization, or—to use the terminology of the old Greeks—the *oikonomia* or the *taxis*. Typical examples for organizations are single

companies, armies, departments of a government, or whole governments of countries. This kind of order is one that is “made” by an exogenous agency or actor; in other words, it is generally a social order that is deliberately planned (Hayek, 1973, p.36). Due to its single planning agency, an organization can also be said to have a “monocentric structure.” An organization typically has a special and definite purpose, which is dependent on the purposes of the agent that has created the organization. Therefore, and with reference to the Greek term *telos*, which means “aim,” it could be said that an organization is a “teleological” social order. It follows that the elements of such an order, that is, the members of the organization must have aims that are in correspondence with the *telos* of the organization, so that its members typically have homogeneous aims. For example, if an army has the aim of conquering a certain territory, each soldier has to share that aim. Similarly, within a commercial company the aims of each employee have to be in accordance with the general aim to make profit.

As the political system of the Central Eastern European and former Soviet Union countries before 1989, socialism was a typical application of organizational principles to whole societies. These political systems were planned by specific actors, such as a party or a politburo, were led by leaders like Stalin or Tito, and they had a certain *telos*, an aim, which consisted of wealth and material equality for the members of the society. But, as Hayek has stated, the fulfillment of material equality stands in a certain conflict with the fulfillment of equality before the law (Hayek, 1960, p.97), so it could be said that socialistic systems are orders of material equality, rather than orders of equality before the law.

Important for our actual consideration is the typical type of rules that is used to form this kind of order. The rules necessary to form an organization are typically prescriptive, relatively concrete, and positively formulated, which means that they say something about what people have to do and instead of only forbidding certain actions. Hayek uses the Greek term *thesis* when he refers explicitly to this specific kind of positive rules (Hayek, 1973, p.126ff). An important feature of these rules that are fundamental for organizations is that they normally do not have the same validity for each member of this order: Normally, neither commands in an army nor orders within a company have the same relevance for all members of the order. It

can be said that the organization is the order of *inequality* before the law.

The capacity of this kind of social order to process information and knowledge is limited because it is bound to the capability of the single planning agency. Additionally, because of the far-reaching absence of equality before the law, the ability of a single member to form correct expectations concerning the future is hindered in an organization. For example, the application of personal skills within a company depends rather on the changeable strategies of the company leader than on abstract formulated rules. In a Hayekian, knowledge oriented and epistemological influenced perspective, this deficit has a negative effect on the efficiency of economic systems.

3. *Catallaxia*

The second kind of social order that is central in Hayek's thinking is the spontaneous order, or – to use again the terminology of the old Greeks – the *catallaxia* or *kosmos*. The term *catallaxia* comes from the Greek verb *kattalein*, which has not only the meaning of exchange but can also mean to make a former enemy to a friend, or to admit someone into a community. It is likely that Hayek got the inspiration to think about spontaneous orders from epistemologist Michael Polanyi (1951, p.154-200). A typical example of a spontaneous order of social relations is the order of the market with all its division of labor. Human language is also an example of a social spontaneous order. An exogenous agency or actor does not make such orders; rather, they evolve spontaneously and endogenously (Hayek, 1973, p.36). Due to the absence of a single planning agency, it can be said that a spontaneous order has a polycentric structure. It is a relatively abstract order, which means that it is – especially for the case of social spontaneous orders – often not necessarily perceptible and not understandable by the human mind. A spontaneous order typically has no special and definite purpose; rather, the single elements of spontaneous orders have their own purposes and aims. Therefore, it could be said that a spontaneous order is a non-teleological social order without a certain collective aim besides the aims of its single elements. Its members can have heterogeneous aims; for example, in a market the buyers and the sellers could have completely different aims, but, nevertheless, they are producing a certain kind of order. One of the social relations in spontaneous orders is the equality before the law of the single members!

Like the principles of the organization, the principles of the spontaneous order can also be applied to whole societies. A market economy, a capitalistic system or – to follow the terminological preferences of Hayek – the *catallaxia* is such an application. The structures of a *catallaxia* are typically not planned by specific actors like a party or a politburo, their elements are independent in determining their aims, their elements are not led by central leaders, and they have no certain *telos*. Rather, the evolution of these structures is dependent upon abstractly formulated rules, which are the same for all elements of that society! Because of the mentioned conflict between the two “equalities,” it could be said that spontaneous market orders – in contrast to organizations – are orders of equality before the law, rather than orders of material equality.

Important for our actual consideration is the typical type of rules that is used to form this kind of order. They are typically proscriptive, relatively abstract, and negative formulated, which means that they say something about what people are not allowed to do instead of prescribing certain and definite actions. Hayek uses the Greek term *nomos* when he refers explicitly to this specific kind of positive rules (Hayek, 1973, p.94ff). But the most important feature of the rules that are fundamental for organizations is that they have normally the same validity for each element of the order. Hayek explicitly addresses this kind of rules when he refers to “rules of just conduct” (Hayek, 1976, p.197), and he explains in detail the evolution of these rules in the process of cultural evolution. These rules, the *nomos*, are necessary to guide a fruitful market process. It can be said that the spontaneous order is the traditional and true order of equality before the law!

The “capacity to process information” of spontaneous orders is regularly higher than the capacity of an organization because the former is not bound by the capability of any single planning agency. Rather, spontaneous orders of persons under a framework of abstract and generally formulated rules that have the same validity for all people are the most effective way to utilize as much as possible from the hidden and economically relevant knowledge about scarcities and about human needs – knowledge that is dispersed within society. The price mechanism is used to transfer and to process the knowledge in spontaneous market orders. It serves as an informational system just as internal “preferences” or “valuations” serve as cognitive instruments within the human mind. And while in a planned order of

inequality before the law expectations cannot be applied to any member of the society in the same way, in a catallaxia all participants in the market process meet as equals before the law, and this fact enables the full utilization of experience in the market process. Additionally, the principle of equality before the law of all participants maximizes the number of competing alternative problem-solving solutions within an economic system and, therefore, the probability of finding the most fruitful product or strategy. As a consequence, the ability of this kind of order to help single economic actors to cope with their cognitive limits is usually very high. This advantage of spontaneous social orders to process more economically relevant knowledge has, as we will see, an effect on the efficiency of economic systems.

IV. Knowledge and The Transformation of Order: Economic Effects of Information Processing Characteristics

The different kinds of rules are economically relevant because they produce different types of orders, and these different orders have different capabilities to process dispersed knowledge. Hayek refers explicitly to the spontaneous order of equality before the law when he describes the most effective way to use the dispersed knowledge: “It is the only procedure yet discovered in which information widely dispersed among millions of men can be effectively utilized for the benefit of all – and used by assuring to all an individual liberty desirable for itself on ethical grounds” (Hayek, 1976, p.70). Therefore, from a Hayekian epistemological standpoint it appears to be economically necessary to restrict individual behavior by general rules because of the cognitive limits of the single mind! It may sound paradoxical that rationality should, thus, require that we deliberately disregard knowledge that we possess, but this is part of the necessity of coming to terms with our unalterable ignorance of much that would be relevant if we knew it. As the Hayekian epistemology has showed us, this paradox is a result of the fact that, in contrast to our superficial, introspective experience, all perception consists of abstractions. With implicit reference to his own epistemology, Hayek states, “It is the great lesson which science has taught us that we must resort to the abstract where we cannot master the concrete” (Hayek, 1963, p.466).

Applying the presented theoretical framework of the different kinds of orders to real economic systems, the process of

transformation from socialism to capitalism can be interpreted as an institutional change from an *oikonomia*, which is based on prescriptive rules and commands that are regularly unequal for the members of the society, to a *catallaxia*, which is based on proscriptive and abstractly formulated rules with the same validity for each member of the society. Furthermore, according to the Hayekian observation that the two possible interpretations of “equality” are in conflict with each other (Hayek, 1960, p.97), transformation can be interpreted as the transformation from a political system that follows the idea of material equality into a system that follows the competing ideal of equality before the law. Regarding the different capabilities of the two orders to utilize the dispersed knowledge in society, it can be said that this institutional transformation to an order of equality before the law also means an improvement in the economic success of the respective order. Such an interpretation could be fruitful for the analysis not only with respect to the transitional countries in Central, Eastern or Southern Europe, but also in other countries that want to strengthen their market economic character, for example, Afghanistan, Iraq, or China.

V. Empirical Study

1. *Rule of Law and Equality Before the Law*

In our considerations of the role of knowledge, we have seen that equality before the law, the basic principle of the spontaneous market order, is supposed to have certain relevance for economic performance. For Hayek, the idea of a non-discriminating social order in which all people are treated equally before the law is not only related to but is the core of the idea of the rule of law (Hayek, 1944, p.87, 92). Since until now no estimation of the realization of equality before the law has been available, we want to make use of this tight relation between the two principles of liberalism.

Kaufmann, Kraay, and Mastruzzi (2003) estimated the realization of the principle of the rule of law. We want to use this index as a proxy for the realization of equality before the law in single transformation countries. To estimate economic performance, we will use the gross national income (GNI) in single transformation countries. To see the relation between these basic liberal principles and economic performance, in Figure 1 we have depicted on the x-axis the estimation variable for the realization of the principle of the rule of law in single transformation countries. The variable ranges

from -2.5 for countries that treat their people completely unequally to +2.5 for the (imaginary) country that provides full equality before the law to its citizens. On the y-axis we can see the gross national income of each of these countries, as measured by the World Bank per year and per capita according to the Atlas method (World Bank, 2003).

Figure 1 clearly shows a positive relationship between the rule of law index of Kaufmann, Kraay, and Mastruzzi (2003) and GNI.

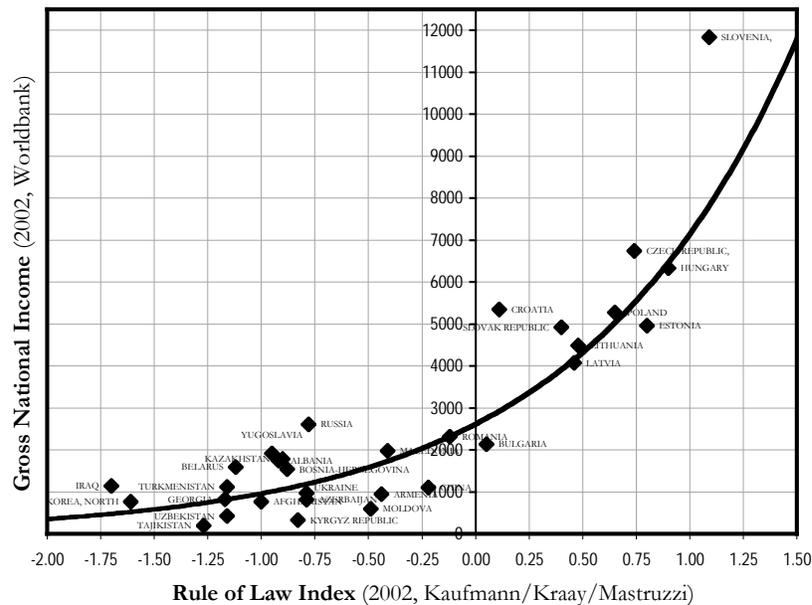


Figure 1: GNI Atlas Method – Rule of Law Index.

2. Constitutional Framework

To support this result, we also want to compare the gross national income with the parameter for “Constitutional, Legislative, and Judicial Framework” in Freedom House’s annual “Freedom in the World” survey; this parameter explicitly refers to the fulfillment of equality before the law (Freedom House, 2004) and could, therefore, serve as an additional proxy. The parameter ranges from 1 for a good constitutional framework and high equality before the law up to 7. Figure 2 presents GNI per capita in 2002, as measured by the World Bank (2003), on the y-axis.

Like in Figure 1, one can see a clear relationship between our proxy for the fulfillment of equality before the law and national income.

3. Explanation of the Results

As we have pointed out, the transformation of former socialistic states to market economies can be interpreted with reference to the Hayekian kinds of orders as a transformation from a society that is organized according to the principles of the organization, to one that possesses the characteristics of a catallaxia. With respect to the institutions and rules that form the order in society, it can also be stated that transformation means an institutional change from an order of mainly prescriptive, concrete commands to an order of mainly proscriptive, abstractly formulated rules. Additionally, we have found that in the Hayekian view the use of knowledge in society plays a crucial role in affecting the success of the overall economic process. Since we have also seen that societies that are organized according to the principles of the catallaxia have a higher capacity to process knowledge than those orders that obey the rules of the organization, it could be expected that the catallactic structures support economic success better.

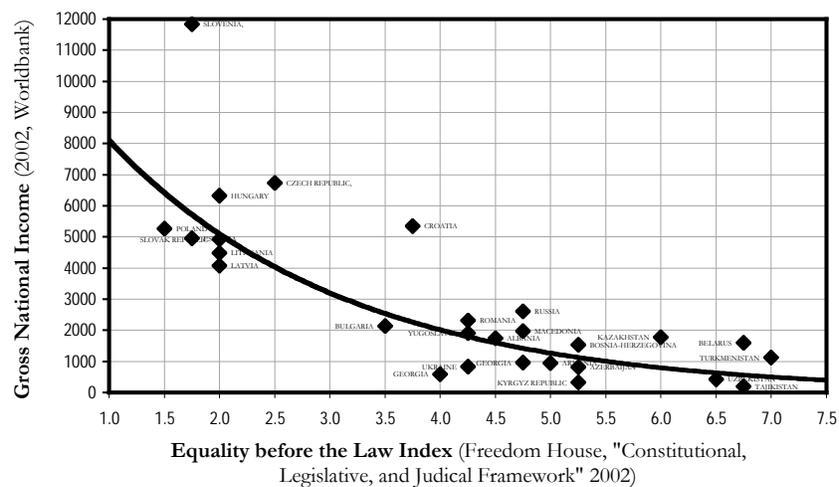


Figure 2: GNI Atlas Method – Freedom House Index “Constitutional, Legislative, and Judicial Framework” 2002.

As we have argued, the order of the *oikonomia* can be expected to have only a low capacity to process economically relevant knowledge. In real socialistic systems that deficit became visible in the poor innovative forces and in the regular shortages in all markets; while lacking innovation is a phenomenon of a lack of discovery of new knowledge, shortages are a phenomenon of a lack of exchange of knowledge about scarcities and needs! On the other hand, the *catallaxia* possesses the necessary characteristics to discover and to exchange knowledge. In capitalistic and *catallactic* systems these characteristics are regularly provided by the mechanism of competition and the price system. The price system serves as an information system just as internal “preferences” or “valuations” serve as cognitive instruments within the human mind. Or, expressed differently, “We need decentralization because only thus can we insure that the knowledge of the particular circumstances of time and place will be promptly used” (Hayek, 1945, p.84).

If we describe the transformation process as a institutional change from *thesis* to *nomos* that means a change to an order of equality before the law, then Figures 1 and 2 show that the more perfectly this change is realized, the more successfully the economy works. Or, in other words, the closer an economic order comes to the ideal of the *catallaxia*, the order of equality before the law, the wealthier the participants of that order can be. But, on the other hand, if political systems adhere to their organizational principles of socialism and of inequality before the law, they omit opportunities to discover innovations and make use of the knowledge that is dispersed among society. Differences in the success of implementation of the principles of the spontaneous market order in the constitutional framework as well as differences in the economic impact of such implementation can be explained, as Zweynert and Goldschmidt (2005) have done recently, with reference to the different cultural legacies and the different “informal institutions” (also with reference to cognitive reasoning) in individual countries.

VI. Conclusion

With respect to the intellectual history of the west and to the work of Friedrich August von Hayek, we have pointed out the importance of the principle of equality of law for liberalism and for economic performance. The systematic place of the struggle of liberalism for equality before the law in Hayek’s work is to be found

in his differentiation between the fundamental principles of order in society. Since in his work the order of equality before the law is the spontaneous order or the “catallaxia,” the transformation from a centrally planned society to a catallactic and spontaneous order can in a Hayekian sense be interpreted as a transformation to a liberal order of equality before the law! And while the principles of the organization can be fruitfully applied in hierarchical social orders such as armies or companies, for whole “open” societies only the application of the principles of the spontaneous order can cause positive effects on the processing of knowledge in these societies.

The role of order in society for the processing of knowledge has been explained with reference to Hayekian epistemology, while the role of knowledge for the economic performance of societies has been explained with reference to his social theory. Additionally, the theoretical relation between the order of a society and its economic performance has been expressed with statistical figures. We have shown that those countries that became better examples of the realization of the liberal value of the rule of law regularly have a higher income per capita. As a consequence, equality before the law is not only important with respect to the fulfillment of human rights in an ethical sense. Additionally, the realization of equality before the law has economic importance, which is by no means an argument with less moral value. With respect to the transitional countries, it could also be stated that the success of transition depends, in addition to many other important parameters, on the grade of the realization of the principle of equality before the law and of the rule of law in those countries! The recommendation to transitional countries from the standpoint of this article is that if these countries want to improve the wealth of their citizens, they need to realize the value of equality before the law! Major steps to fulfill this goal would be to install and to respect constitutional structures and to realize and to adhere to the basic principles of liberalism.

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