

**F. A. Hayek: A consideration of Austrian Economics in the
Modern Political Environment**

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1.1 Introduction

In light of the current global economic climate and the potentially severe implications that it will have for economic policy makers and theoreticians in years to come, now is a prudent time to reconsider our political philosophies and more importantly, allegiances. As in all times of economic upheaval, people begin to search for new answers to the problems at hand. History shows us that, with the failure of one economic system, another will rise in its place to blow wind into the sails of economic policy makers until the breeze may change yet again. The present wind blows us back West in the direction of Maynard Keynes whose work, although once considered the key stalwart of economic policy making fell out of favour long ago. However, the famous words once coined by Milton Friedman and made famous by Richard Nixon are being uttered again - "We are all Keynesians now". Rather than revisiting failed and abandoned doctrines however, should politicians and economists alike not be considering yet untested ideas which may hold the answers to questions which are at the core of macroeconomic policy making, primarily – to what degree should the Government intervene in the economy?

Of particular interest in this paper is the works of the Austrian school of economic thought, and one of its most noted exponents, Friedrich August von Hayek. The central theme of all Hayek's work was the question of freedom and individual liberty.¹ Of further interest, as shall be analysed below, is the position taken by the current Australian Prime Minister, Kevin Rudd on the works of the Austrian economists. Rudd's open and ill contrived attempts at discrediting the works of Hayek in order to support his own political views as a social democrat are perhaps a sign of our current Prime Ministers ignorance in the history of economic thought. These views of our Prime Minister include a highly interventionist approach to economic policy making. So, at a time when government intervention in the economy, not just in Australia, but throughout the world, is reaching new levels, now is a good time to be considering the works of the free market men such as Hayek and apply the lessons we may learn from them to Australia's current political policies.²

2.1 Hayek and the Austrian Economists

Friedrich August von Hayek was born on May 8, 1899 in Vienna, Austria. He gained a Doctorate of Law and Doctorate of Political Science in 1921 and 1923 respectively at the University of Vienna. From 1927 until his retirement from institutional academia in 1967, Hayek filled a number of different Economics Professorship and Directorship positions at various universities across the world.³ During this time, Hayek received many awards for his academic achievements, including the Nobel Prize in Economics. Hayek has also been acknowledged as "... the person most responsible for founding the [Mont Pelerin] Society" in 1947.⁴ Following his retirement, Hayek still remained active in the circles of academia until his death in 1992. A man of varied interests, Hayek not only studied and wrote on economics, but also the other social sciences, psychology, history and political philosophy. Throughout

¹ To Hayek, the terms 'freedom' and 'liberty' were interchangeable, although his preference was for the latter; See Hayek F A, *The Constitution of Liberty* (Routledge Press, 1960) 11, 421.

² This sentiment is not dissimilar from that of George C Roche in 1975; "This widespread discussion of [Hayek's] work comes at a time when the mistaken assumptions of contemporary state interventionism and socialism have produced social, economic, and political deterioration on the grand scale. The clarity and perception of Hayek's world view are needed now as never before". See; Roche G, C, 'The Relevance of Friedrich A. Hayek' in *Essays of Hayek* (Ed. Fritz Machlup) 1977, Routledge & Kegan Paul Ltd, 1.

³ Hoy, C M, *A Philosophy of Individual Freedom: The Political Thought of F. A. Hayek* (Greenwood Press, 1984) 3.

⁴ Friedman M, 1976, Chicago.

all his works, Hayek's primary focus was on the importance and preservation of individual liberty.⁵

Hayek's work holds a close allegiance with the Austrian school of economic thought. He is widely considered to be one of their leading exponents. The Austrian school of economic thought is the name dedicated to a group of economists and economic ideas spanning history since the time of St. Thomas Aquinas. The name 'Austrian' is inspired by the geographical origin of many of its advocates such as Ludwig von Mises and Carl Menger. The distinguishing feature of these ideas is the promotion of a free market, or the restriction of government involvement in the economy. As argued by Mises, one of the leading Austrian economists and Professor Hayek's teacher, '[T]he first job of an economist is to tell governments what they cannot do'. Beyond this, like all economic schools of thought, the works of the Austrian economists was varied and wide ranging. Fritz Machlup however identified six main 'tenets' which he believed to be generally accepted by all Austrian economists.⁶

1. *Methodological Individualism*. Ultimately, we can trace all economic phenomena back to the actions of individuals; thus individual actions must serve as the basic building blocks of economic theory.
2. *Methodological Subjectivism*. Economics takes man's ultimate ends and judgments of value as given. Questions of value, expectations, intent and knowledge are created in the minds of individuals and must be considered in this light.
3. *Marginalism*. All economic decisions are made on the margin. All choices are choices regarding the last unit added or subtracted from a given stock.
4. *Tastes and Preferences*. Individuals' demands for goods and services are the result of their subjective valuations of the ability of such goods and services to satisfy their wants.
5. *Opportunity Cost*. All activities have a cost. This cost is the most highly valued alternative that is foregone because the means for its satisfaction have been devoted to some other (more highly valued) use.
6. *Time structure of consumption and production*. All decisions take place in time. Decisions about how to allocate resources for the purposes of consumption and production across time are determined by individuals' time preferences.

Machlup also identified what he believed to be two more 'highly controversial' beliefs of the Austrian economists, however many consider them to be the central foundations upon which the Austrian school is built:

1. *Consumer Sovereignty*. In the marketplace, consumer is king. Consumers' demands drive the shape of the market and determine how resources are used. Intervention in the marketplace stifles this process.
2. *Political Individualism*. Political freedom is impossible without economic freedom.

To Hayek these principles were central to his work on political philosophy and individual liberty.

3.1 Hayek and Political Philosophy

Hayek dedicated much of his published works to the questions of political philosophy and more specifically individual liberty within the political framework. *The Road to Serfdom*, published in 1944, which is one of Hayek's most well known books, is held up as one of the more influential expositions of the libertarian analysis of society and government. It was

⁵ As above, n3, 4.

⁶ Machlup F, (1982, 42); See Samules, W, et al, *A Companion to the History of Economic Thought* (Wiley-Blackwell) 2003, 446.

however *The Constitution of Liberty*, published in 1960 as a sequel to *The Road to Serfdom*, that many thought was one of Hayek's finest works on political philosophy. Lord Robbins stated; "I would venture to pick this out, together with his earlier papers on similar topics, as one of Professor Hayek's most enduring contributions to our subject".⁷ In another book, *The Fatal Conceit: The Errors of Socialism*, published in 1988 Hayek argued that '...to follow socialist morality would destroy much of present humankind and impoverish much of the rest'. These books and the countless other academic works which Hayek devoted to the subject of political philosophy all present different angles on Hayek's key focus, individual liberty.

Although an advocate of individual liberty, Hayek did not believe we would ever reach a state of perfect freedom. Rather, he argued that there would always be scope for the State to hold coercive powers over individuals in order to prevent individuals from exercising coercion over each other of a more severe kind.⁸ This clarification is by no means a restriction on Hayek's ideal of individual freedom, but rather a necessary concession to the Rule of Law in order to preserve social values.⁹ In *The Constitution of Liberty* Hayek stated, "[F]reedom under the law...is the chief concern of this book".¹⁰ Hayek and the Austrian economists are not alone in these views. Free market or 'libertarian' thinkers which preceded Hayek such as the Physiocratic and Classical economists also advocated a *laissez faire* political structure. One of the leading Physiocratic economists, Francois Quesnay, argued that the only role for Government to play was to protect property rights by "keeping down the thieves and blackguards".¹¹ Further Adam Smith argued that government had only one essential function which was to ensure national defence.¹² All of these viewpoints stress the fact that the government's primary function was to uphold the well established social values of society through the Rule of Law in order to allocate and protect property rights. Beyond this however, the role they play in the economy should be minimal.

In all of his works, Hayek argued for freedom and liberty of individuals, he did not however support an anti altruistic hegemony. Hayek did argue that some social practices which inhibited the growth and development of society should be cast aside, but this did not include attributes such as compassion and charity. Further, Hayek did not argue against all forms of social welfare but rather that some forms of social welfare are to be discouraged "[I]nsofar as this means that the coercive powers of government are to be used to insure that particular people get particular things, it requires a kind of discrimination between, and an unequal treatment of, different people which is irreconcilable with a free society".¹³ Hayek argued that this form of social welfare would lead back to socialism and its coercive and arbitrary methods which are inconsistent with individual liberty, thus should be discouraged.

4.1 Hayek and Kevin Rudd

Prior to his election as Prime Minister, Kevin Rudd was promulgating the opinions of an economic conservative. It seems however, that in times of economic hardship and more importantly, leadership, Rudd's true interventionist colours have come out. Rudd's criticism of the libertarian thinkers seems to go hand in hand with his highly interventionist policies. In

⁷ Robbins, L, 'Hayek on Liberty' *Economica*, February 1961, 66 – 81.

⁸ Hayek F A *The Constitution of Liberty* (Routledge Press, 1960) 12,21.

⁹ Ludwig von Mises has described this as the avoidance of the 'noble savage' or the 'trousered ape'.

¹⁰ Hayek F A, *The Constitution of Liberty* (Routledge Press, 1960)

¹¹ Quesnay, F, *Principaux économistes* (Frankfort, 1888)

¹² Smith A, *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776)

¹³ Hayek F A *The Constitution of Liberty* (Routledge Press, 1960) 259 – 260.

a recent article, Rudd wrote, “The current crisis is the culmination of a 30-year domination of economic policy by a free-market ideology that has been variously called ‘neo-liberalism’, economic liberalism, economic fundamentalism, Thatcherism or the Washington consensus”.¹⁴ This is hardly the views of an economic conservative, but rather of one of the most interventionist Prime Ministers which Australia has ever seen in office.

The opinions of Rudd in blaming a ‘free-market’ approach for the current global financial crisis not only reflect a gross misinterpretation of economic policy over the last 30 years but also of just what constitutes a ‘free-market’ according to Hayek and other Austrian economists. Over the last 30 years, the approach of the Australian government (along with other governments throughout the world) has been anything but non-interventionist as is described in Hayek’s works. Rather, the dominant orthodoxy has been one of social democracy. In fact, the interventionist approach of the American government in its economy is considered to be a root cause of the current global financial crisis. John Taylor wrote;

“My research shows that government actions and interventions – not any inherent failure or instability of the private economy – caused, prolonged and dramatically worsened the crisis”.¹⁵

Despite Rudd’s severe misinterpretation of the past 30 years of economic policies and events, he is also wrong in regards to the specific criticisms which he draws of Hayek and the Austrian economists. One of Rudd’s primary challenges with Hayek’s works is that “Friedrich Hayek...argued that the only determinant of human freedom was the market”.¹⁶ This however is a gross misinterpretation of Hayek’s works. Hayek was not arguing for the market as the exclusive instrument to guarantee individual liberty. As described above, Hayek and others of like minded ideas, which Rudd has branded with the title of ‘fundamentalist economists’¹⁷ support a degree of government intervention in the form of the Rule of Law. Hayek concedes this to be a necessary concession to state control in order to maintain social values and protect property rights so that individuals can maintain their freedom from others as well as the state. Rudd however pushes his interpretation of Hayek’s works: that Hayek is arguing for the Market or nothing, without pausing to understand the fundamental crux of Hayek’s work on political philosophy, that the two are not inverse forces.

Kevin Rudd also argues against the ideas of Hayek and the Austrian Economists as he believed that Hayek “argued that any form of altruism was dangerous because it distorted the market”.¹⁸ Again, this is an ill informed and surprising interpretation of the works of Hayek. Anyone who has read Hayek’s work on political philosophy would know this to be not true. Again, as has been highlighted above, Hayek in no way dismissed the need for charity and compassion in society. Rather, he promoted the abandonment of atavist practices which are no longer in line with modern society.¹⁹ Mises captures well the sentiments of the Austrian economists on this point when he stated that “Everyone carries a part of society on his

¹⁴ Rudd, K, ‘The Global Financial Crisis’, *The Monthly* (Feb 2009)

¹⁵ Taylor J, *Wall Street Journal* (09/02/09)

¹⁶ Rudd, K, ‘Child of Hayek’ *The Australian* (20 December, 2006)

¹⁷ *Ibid.*

¹⁸ *Ibid.*

¹⁹ Hayek, F. A, *New Studies in Philosophy, Politics, Economics and the History of Ideas* (Routledge & Kegan Paul, 1978) ch. 5

shoulders...no one is relieved of his share of responsibility by others. And no one can find a safe way for himself if society is sweeping towards destruction”.²⁰

5.1 Conclusion

With the emergence of the Global Financial Crisis and the government’s response to its effects, it is apparent that we are to see little development in the minds of government economic policy makers, rather we are witnessing a digression or a backtrack towards outdated and disproved Keynesian policies. Kevin Rudd seems content to simply continue along the interventionist economic policy path which the different Australian governments have been walking for the last thirty years. He also seems intent on justifying his decision to act thus on false logic and fundamental mistakes in the interpretation of economic history and the history of economic thought. He has seemingly picked a target in the form of the Austrian economists and one of its most well known members, Hayek. As has been demonstrated above, a basic understanding of Hayek’s works shows how obviously wrong Kevin Rudd’s interpretation is. We are witnessing now an interesting if not frightening glimpse of the degree of interventionism government policy may take in the future, and unfortunately the current global climate provides evidence of the impact this may have. We must continue arguing against big government so as to promote individual liberty and avoid ‘*the fatal conceit*’.

²⁰ Mises, L, *Socialism: An Economic and Sociological Analysis* (Gustav Fischer Verlag, 1922) 468 – 469.

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