



With the country crawling out of the worst recession since the Great Depression, it's no surprise that the economy is on everyone's mind. According to the latest Gallup poll, seven in 10 Americans point to economic issues as the most important problems facing the country.

These worries about the economy inevitably give rise to debates about the government's proper role in hastening recovery and forestalling future recessions.

On the one hand are those who call for interventionist policies to stimulate the economy. According to this view—espoused by many on the Left—the government ought to spend more. We need another stimulus, they say, as the initial \$800 billion one was not large enough to revive a sluggish economy.

While economists do not agree on whether such interventionist prescriptions actually work, there is no question that stimulative fiscal policies swell the deficit and contribute to our ballooning debt. As Clive Crook of the

Financial Times put it: “What the stimulus gives, the debt projections take away.”

A less sanguine set of ideas about the prospect of government-fueled recoveries comes from Friedrich Hayek, the author of the classic *Road to Serfdom* and one of the most important economists of the 20th century.

In a new essay published by The Heritage Foundation, Bruce Caldwell, the Director of Duke University's Center for the History of Political Economy and the editor of *The Collected Works of F.A. Hayek*, distills the key Hayekian insights on what to do—and not do—during difficult economic times.

Caldwell's conclusion: “We usually don't have the necessary knowledge to intervene effectively in the economy, and the political process is such that, even if we did, we still likely would get bad policy, coupled with an ever-growing government sector.”

With a little help from public choice theorists, here then are the 10 Hayekian insights for trying economic times:



1. RECESSIONS ARE BOUND TO HAPPEN.

Shifts between periods of economic growth and periods of stagnation or decline are a necessary and unavoidable part of a free-market monetary economy. Downturns are not aberrations but rather painful and necessary medicine for restoring equilibrium to the economy.

This insight, however, does not mean that all recessions are natural: Government meddling in the economy—e.g., keeping interest rates too low for too long—will lead to malinvestment—too many investment projects get started that cannot ultimately be sustained—and culminate in a recession.

2. CENTRAL PLANNING AND EXCESSIVE REGULATION SURE DON'T WORK.

The desire to plan and to subject the economy to the rule of experts endangers liberty. As Hayek succinctly noted: “The more the ‘state’ plans, the more difficult planning becomes for the individual.”

Hayek argued that central planning, if fully implemented, would lead to disastrous economic results and ultimately to restrictions on political and personal freedoms.

3. SOME REGULATION IS NECESSARY.

Hayek made it clear that he was not advocating a system of pure *laissez-faire*, but one with a general system of rules that would enable individuals to carry out their own plans. Hayek’s contribution was to stress the importance of institutions—a market system, in a democratic polity, with a system of well-defined, enforced, and exchangeable property rights, protected by a strong constitution, and operating under the rule of law, in which laws are stable, predictable, and equally applied.

4. A STIMULUS WILL ONLY STIMULATE THE DEFICIT.

Past experience with trying to fine-tune the economy shows that counter-cyclical fiscal and monetary policy can sometimes make matters much worse (as in the 1970s). Wise politicians would therefore be advised not to meddle, however much their instincts tell them to show voters they’re doing something.

5. THE ECONOMY IS TOO COMPLEX FOR PRECISE FORECASTING.

As Yogi Berra could have said: “I hate making economic predictions. Especially about the future.” It’s not that we don’t know anything, but rather that what we do know reveals the limits of our knowledge, and consequently, of our ability to plan and forecast. When the knowledge problem is joined with other political and economic obstacles, the hope of getting rational policy out of Washington becomes very dim.

6. REMEMBER THE RULE OF UNINTENDED CONSEQUENCES.

History shows that when trying to realize certain ends—particularly when their achievement involves interfering with the workings of the price mechanism—all sorts of pernicious effects will occur that were not part of the original plan (see #10).

Hayek was not altogether opposed to experimentation and change, but thought that piecemeal change is always preferable to wholesale attempts to remake society anew.

7. YOU WON'T BELIEVE HOW MUCH YOU'LL LEARN IN ECON 101.

While Hayek repeatedly pointed to the limitations inherent in a discipline that deals with a complex system like the economy, the basic principles of economics—scarcity, supply and demand, division of labor, etc.—can explain a lot about the world and help rule out cer-



tain inappropriate policy responses (e.g. price ceilings).

A good economics course will therefore help to identify more appropriate policy responses—responses that utilize markets rather than fixing prices or trying to legislate specific outcomes.

8. LEAVE SOCIAL JUSTICE OUT OF IT.

Free markets necessarily lead to an unequal distribution of wealth and, just as inevitably, fuel calls for egalitarian social justice, as anyone who's read the editorial page of *The New York Times* or perused *The Huffington Post* knows. Hayek viewed such cries as misguided and dangerous.

First of all, he denied that justice applies to an impersonal market process: A person's or an organization's actions may be just and unjust, but the market process is not planned and the income distribution it generates has nothing to do with justice.

Secondly, the egalitarian demands of those who clamor for social justice violate the principle of the rule of law. If people differ in their attributes, then different people will necessarily experience different outcomes. The only way to get similar outcomes for different people is to treat them differently.

Lastly, redistributive schemes presume that we possess knowledge that we, in fact, can never possess (see #5).

9. NOTHING BEATS THE FREE MARKET.

Hayek admitted that if we had more knowledge we could do a lot more to improve the world through planning and regulation. But we don't, and in the world of dispersed knowledge we live in much of the knowledge we actually do possess is due to the workings of the market mechanism.

In a world that is filled with unpredictability, where the man on the spot has only his own small bit of local (and sometimes tacit)

knowledge, market signals provide information on which he can base his decisions. His decisions, together with those of millions of others, feed into the system to form the prices that emerge. Bad decisions and mistakes are constantly made, but in a market system, errors made by some are opportunities for others, and the latter's profit-seeking actions help to correct them.

The self-regulating market system, when it is functioning well, reduces some of the unpredictability that we all face in the economic arena and helps to coordinate our actions with those of millions of others. It also allows individuals to act on their own local knowledge and thereby allows others to make use of that knowledge even though they do not possess the knowledge themselves.

10. AS A RULE OF THUMB, GOVERNMENT CURES ARE NOT ONLY WORSE THAN THE DISEASE, BUT LEAD TO FURTHER DISEASE.

When you consider that bureaucrats have an incentive to maximize bureaucracy, that politicians who seek reelection—and which ones don't?—have an incentive to increase spending and decrease taxes, and that corporations have an incentive to squeeze out the competition through government conferred advantages, you'll conclude that the free market remains our best option (see #9).

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