

HAYEK'S BEST TEST OF A GOOD ECONOMIST

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A careful reading of the quotations that Hayek left us upon his death on hundreds of cards explains what is, in his opinion, the ultimate and definitive test of whether or not someone is a true economist. It is curious to draw attention to the fact that Hayek had already referred to this matter in Appendix III to his *Pure Theory of Capital*, which he wrote in 1941 and which ends with the following words: «More than ever it seems to me to be true that the complete apprehension of the doctrine that 'demand of commodities is not demand for labour' is 'the best test of an economist'» (Hayek 1976, p. 439). Here, Hayek wishes to highlight one of the key points of the theory of capital: the real productive structure is very complex and is formed by many stages, in such a way that an increase in the demand for consumer commodities will always be detrimental to employment in the stages furthest away from consumption (which is precisely where most of the workers are employed). Or, in other words, the employers can perfectly well earn money, even if their revenue (or «aggregate demand») drops, if they reduce their costs by replacing labour by capital equipment, thus indirectly generating a significant demand for employment in the stages of capital goods production furthest away from consumption (Huerta de Soto 1998, pp. 213-313).

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It is more than illustrative how Hayek, in the select group of quotations on economic theory that he has left us in hundreds of his handwriting cards, wished to refer, once again, to these key ideas of the theory of capital. Effectively, Hayek now tells us that «Investment is more discouraged than stimulated by a high demand for consumer goods, and so is employment *because in an advancing economy more workers are employed to work for the distant future than for the present*»(emphasis added). And he also says that «In the end is the *decrease* of final demand at current prices that leads to new investment to reduce costs». Therefore, Hayek concludes that «employment is not determined by aggregate demand». In short, for Hayek, the best test for an economist is to understand the implicit fallacy contained in the underconsumption theories and in what is called the shrift paradox or paradox of saving: «It is not consumer's demand that secures the generation of incomes. It is investment of the excess of incomes over consumer's expenditures which keeps incomes up». A large number of economists are unable to understand these principles because they adopt the macroeconomic aggregate approach that Hayek considers to be a serious error that leads, in the final analysis, to social engineering and socialism («Socialism is based on macroeconomics —a scientific error»). The only way of understanding what happens at «macro» level is by using microeconomics: «We can understand the macrosociety only by microeconomics». Furthermore, even the Chicago School monetarists are victims of this error: «Even Milton Friedman is reported to have once said 'we are all Keynesians now'». The approach based on the model of equilibrium and macroeconomics is erroneous because «a science which starts with the conceit that it possesses information which it cannot obtain is not a science». The same may be said of Welfare Economics, which, for Hayek, is «the spurious scientific foundation of socialist policies».

The test of the economist is broadened to include the understanding of the essential role of economic calculation and the estimation of opportunity costs that are made possible by market

prices, in the extended order of social co-operation. In fact, «not before the understanding of opportunity costs (i.e. alternatives forgone) was there an adequate science of economics». This essential idea was never understood by the classical economists and is still today «obscured by the Marshallian compromise» or, as is even better expressed by Hayek in another quotation, «by the long dominance of the wishy-washy Marshallian compromise». For Hayek, furthermore, «economics is the science that can demonstrate that rationalism is wrong because rational knowledge of facts is not sufficient» and that allows us to conclude that «the destroyers of western civilisation were some of the great rationalist thinkers of the 19th century, Bentham, Mill, Russell and Keynes». Thus, «The powerful seducers are no longer Marx and Engels, Proudhon or Lenin but Keynes, Tinbergen, Galbraith and Myrdal, Leontieff and Dworkin, etc., etc. They are to me the enemies of the great extended society». All of them share, to a greater or lesser extent, «The idea that without the existence of a market men would know as much as they do within a market system (which) is the fundamental error of those who, like Oskar Lange, assert the possibility of an effective economic calculation in a socialist economy». In short, for Hayek, «The fools are those who believe they know more than they do, that is the rationalists».

On one occasion, Ludwig von Mises wrote that «what distinguishes the Austrian School and will lend it immortal fame is precisely the fact that it created a theory of economic action and not of economic equilibrium or non-action» (Mises 1978, p. 36). Hayek, in turn, takes Mises' idea to a general level and writes, on one of his cards, that «The main achievement of the Austrian School is that it has decidedly helped to clear up the differences which inevitably must exist between science dealing with relatively simple phenomena [macroeconomics, model of equilibrium] and science of highly complex phenomena» [the true market process]. And perhaps, today, the best test of an economist is his full understanding of this essential difference.

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