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HAYEK (1899-1992) ON GOVERNMENT

by

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Abstract

Hayek's belief in freedom, and his idea of the market as an efficient means solving the knowledge problem, generate his view that the role of government must be confined to constructing a stable framework of the rule of law. All else is to be determined by the competitive market. However, a thorough examination of Hayek's policy position reveals another Hayek on government. This Hayek recognised the duty of government extended beyond policies which underpin and improve the competitive market. Hayek's exceptions to laissez faire were guided by considerations of social welfare, an appreciation of the failures of the competitive market, and changing ideas about policy. The presence of two views on government constitutes an inconsistency in Hayek's position. It also demonstrates the difficulty of designing a "constitution of liberty" which provides a workable policy framework.

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HAYEK (1899-1992) ON GOVERNMENT

Introduction

In 1975, Margaret Thatcher, then Leader of the Conservative Party Opposition, met with the Party's Research Department. The meeting was to consider a policy paper which argued a pragmatic middle way between the extremes of Right and Left. However, a middle way was unacceptable to Thatcher. Before the presentation of the paper had finished, she produced a copy of Hayek's *The Constitution of Liberty* (1960). "This is what we believe" she said, as she slammed the book on the table (Cockett, 1995, 174).

The first objective of this paper is to correct the popular misconception about Hayek on government, typified by Thatcher's remarks. Thatcher was right about Hayek's *purpose* in *The Constitution of Liberty*, but wrong about his *achievement*. The second is to reject the interpretations that have been offered by the principal modern critics, Brittan (1983) and Gray (1989). The paper supports the criticism by Keynes of Hayek on the role of government in *The Road to Serfdom* (Keynes, 1944, in Cockett, 1995, 89), and finds evidence for Keynes' criticism in Hayek's later works on policy, *The Constitution of Liberty*, and *Law, Legislation and Liberty* (1976). Finally, the paper contributes to an understanding of the nature of policy by demonstrating the difficulty of establishing permanent rules for policy.

The theme of the paper is that there were two Hayeks on government. One dated from the rise of Nazi and Soviet totalitarianism in Europe, and the interventionist role of government contained in the Beveridge proposals for social security. For this Hayek, there was no middle road between liberalism and totalitarianism. Any move beyond a minimum role of government would inexorably be the "road to serfdom". Government must be confined to constructing a stable framework of the rule of law in which coercion is confined to enforcing the rule of law, collecting taxes and ensuring external security, and all else is determined by the competitive market. The role of policy was to make the market as competitive as possible. This is the Hayek Margaret Thatcher understood.

A thorough examination of Hayek's policy positions reveals another Hayek on government. This Hayek recognised the duty of government extended beyond policies which underpin and improve the competitive market. These exceptions and qualifications to laissez faire were guided by considerations of social welfare, an appreciation of the failures of the competitive market and changing ideas about policy. Hayek tried to show that the way is open for government to do more than support the competitive market, by following rules that are consistent with the liberal order. However, the rules are flawed. Some of the policies Hayek advocated are inconsistent with the rules. Hayek failed to establish a *policy* position which avoided the middle way. In addition, Hayek tended to be unclear about the implementation of policy. This tendency is reinforced by Hayek's changes of mind about the rationale for the role of government and the required policy.

Hayek's work comprised a system of ideas (Gray, 1984, 2). To understand Hayek's views on the role of government requires an understanding of that system. This system is presented in Section 1. The rules for government which ensure a liberal order are presented in Section 2. The roles Hayek assigned to government are discussed in Section 3. The Conclusion emphasizes the inconsistency of Hayek's "constitution of liberty" with his policy position, and draws some implications about the nature of policy (Section 4).

1. Hayek's System

Values

Hayek's central value was liberty, by which he meant that "the coercion of some by others is reduced *as much as is possible* in society" (CL, 11 - emphasis added). Liberty is not the freedom *to do* certain things, but freedom *from* the will of others. Liberty is

respect for the individual man qua man, that is the recognition of his own views and tastes as supreme in his own sphere, *however narrowly that may be circumscribed*, and the belief that it is desirable that men should develop their own individual gifts and bents (RTS, 11 - emphasis added).

Whether an individual is

free or not *does not depend on the range of choice but on whether he can expect to shape his course of action in accordance with his present intentions*, or whether somebody else has power so to manipulate the conditions as to make him act according to that person's will rather than his own (CL, 13 - emphasis added).

Freedom is being able to "decide what use we shall make of the circumstances in which we find ourselves" (CL, 19). It is being able "to order our own conduct in the sphere where the material circumstances force a choice upon us" (RTS, 157). Liberty is freedom from the "arbitrary will of another" (Hayek, 1962, 229). No one has the moral right to impose their values on anybody else.

Coercion occurs when one man's actions are made to serve another man's will, not for his own but for the other's purpose...Coercion is thus bad because it prevents a person from using his mental powers to the full and consequently from making the greatest contribution that he is capable of to the community (CL, 133-134).

Coercion is a matter of being subject to the will of another. This means the individual's material circumstances are irrelevant to his freedom. One may be rich and subject to coercion, or poor and free (CL, 17).

Although for Hayek freedom was "desirable for itself on ethical grounds" (LLL:2, 71, and see also CL, 68), its primary justification was as a means. According to Hayek, following Kant, "welfare has no principle...it depends on the material content of the will, which is dependant on particular facts and is therefore incapable of a general rule" (quoted in FC, 73). There were two arguments for freedom in Hayek's interpretation of Kant's view. One is that people have different values (RTS, 45). There is no "complete ethical code" in which "all different human values are allotted their due place" (RTS, 43). Hayek's solution to the problem of competing values was to avoid the issue of value choices, by giving people the freedom to decide for themselves "as much as is possible" what they want. The second argument for freedom is the "inevitable ignorance of all of us concerning a great many of the factors on which the achievement of our ends and welfare depends" (CL, 29). This is the ignorance of Kant's "particular facts". The individual can only use "all his unique combination of information, skills and capacities which nobody else can fully appreciate" if he is free (Hayek, 1962, 233). In so far as society is

controlled or directed, it is limited to the powers of the individual minds which control or direct it (Hayek, 1945a, 32). Because we do not know how people will use their freedom, we do not know who will do things of benefit to society, so everyone must have freedom (CL, 32 and Hayek, 1945a, 15).

Hayek's final argument for freedom was it generates intellectual, moral and material progress (CL, 394). Material progress generates a level of real income in which the share of each individual is "as large as we know how to make it" (Hayek, 1968, 186). Progress constitutes the "general good" arising from "the facilitation of the pursuit of unknown individual purposes" (LLL:2, 1). However, the essence of freedom is that its benefits are "unknown and uncertain" (CL, 68). Freedom does not guarantee progress, rather it is *more likely* to generate progress than any alternative.

The Rule Of Law

Freedom can only be exercised if people subject their behaviour to restraint. Restraints limit what people can do, but Hayek argued there is no freedom without rules of law and conduct (LLL:3, 163, Hayek, 1945a, 11 and 24, note 23). The rules must be known beforehand, embody abstract, normative principles, and have uniform application.

Rules must be known in advance so that they constitute data in relation to which men can plan (CL, 153 and RTS, 60). Rules then become an "instrument of production" (RTS, 55). The rules are like the laws of nature: if they are known beforehand, the individual can use his knowledge of the rules to achieve his aims, just as he can use his knowledge of the laws of nature (CL, 142). For Hayek, known rules enable the individual "to make the fullest use of his knowledge". This is because the "law tells him what facts he may count on and thereby extends the range within which he can predict the consequences of his actions" (CL, 156-157). Rules that are known beforehand are not coercive, because the individual can avoid putting himself in a situation where he would be subject to the rule (CL, 142).

The rules must express abstract, normative principles. They must not have "concrete ends" or apply to "particular sets of circumstances" (LLL:3, 20). Their effect on particular individuals cannot be foreseen at the time they are laid down (CL, 153-159 and LLL:3, 112). By not serving particular ends, abstract

rules serve values, or the preservation of a kind of order (LLL:2, 15). They will eliminate certain choices for the individual, but will not limit the choice to some specific action that somebody else wants him to take. With abstract rules "all is permitted that is not prohibited" (CL, 19). In this way, rules give people the freedom to make the greatest use of their knowledge, because the rules have nothing to say about the particular circumstances of time and place (RTS, 56-57). Such rules are not coercive (CL, 154-155) and increase everyone's chances equally:

Mothers who could never agree whose desperately ill child the doctor should attend first, will readily agree before the event that it would be in the interests of all if he attended the children in some regular order which increased his efficiency. (LLL:2, 4).

The content of the abstract principles must be "deeply ingrained moral beliefs" which command agreement among men (CL, 62). Rules require social agreement, and this will only be possible for general principles, for agreement is more difficult the more specific the issue is (LLL:3, 17). Agreement to the rules is critical because coercion can only be a minimum if individuals can be expected to conform *voluntarily* to the abstract rules (CL, 62).

Finally, rules must have uniform application. The rule must be the same for everyone. This is equality before the law, which is Hayek's notion of justice. The rules of law and conduct are just if they are the same for all. Rules are not coercive when they apply equally to all (CL, 154-155). Discriminatory rules, specific commands or the granting of certain privileges for particular individuals are all inconsistent with justice (LLL:3, 100). Justice will produce unequal outcomes, because people are different. However, to have rules which aim to do the reverse, that is, produce equal outcomes, requires discriminatory rules. This would be inconsistent with freedom (CL, 275). So the consequence of the rule of law is economic inequality (RTS, 59).

The Idea of the Market

The starting point of the economic problem is that all the individual members of the economic system have some knowledge about their skills, opportunities and values. Much of this knowledge is tacit or unconscious. Thus, it often cannot be communicated as knowledge that others can use. Freedom gives individuals the scope to use this knowledge and take account of their "peculiar"

knowledge. This means more information is used, because more questions are asked and more answers found (*LLL:2*, 9 and *FC*, 77).

Prices are generated by people acting on their plans through exchange. Prices summarise the knowledge of individuals about their values and the costs of production. As such, they communicate a great deal of knowledge in an abstract way. Prices summarise more knowledge than any individual can acquire. Prices allow the individual to use tacit knowledge in decisions about values and costs and to take advantage of the knowledge of others, without having that knowledge. Decisions about production and consumption taken in relation to price can be made without self-examination in relation to values and in ignorance of the events affecting the market (*LLL:3*, 162). The feature of the market is that people need not know very much to make good decisions, if they rely on price signals (Hayek, 1945b, 86).

Price provides "a readily intelligible yardstick" by which to make informed choices (Hayek, 1968, 187 and *LLL:2*, 72). Price also constitutes an "external pressure" for men to give their best (*RTS*, 93). Prices are a communication system, with positive and negative feedback loops, because they communicate information about opportunities and errors. The difference between expected prices and the costs of provision provides information to entrepreneurs about the value to society of resource allocation. Prices reveal where the market (and society) believes benefits lie. Costs reveal the values that must be given up. If there is a positive difference, it indicates an improvement in the use of resources is possible. By performing this guidance function, prices lead producers to serve unknown consumers with unknown ends, ends that the producer does not need to know, and which are irrelevant to the decision he makes about what to do (*FC*, 59 and 100). The knowledge society has about least cost methods of production and about consumer values is *created* by the market process. Without competition they would not be known (*LLL:3*, 75). It is because of the market " that people know at least as much about possibilities and opportunities as they in fact do" (Hayek, 1946, 106).

The market is a means of adaptation. Society requires a means of adapting to change successfully if it is to survive and prosper. Change can only be resisted at the cost of falling income. The market is the most effective means of adaptation because it relies on decentralisation, so individuals, who are best placed to make decisions about themselves, can make decisions about how to

adapt. Change will only be known to some (and even for them, knowledge may only be partial, for the adaptation to the unknown unfolds slowly). The market spreads this knowledge by prices, and shares the consequences. The adaptation may not be perfect, but it is the best there is. This ability to adapt is why the market societies survive and prosper (*FC*, 76), even though usually no one will know how the necessary adaptations will be brought about (*CL*, 400). The adaptation to unforeseen events will always mean someone is hurt (*LLL:1*, 63). Competition discovers which plans are "false" (*LLL:2*, 117), which disappoints or defeats some expectations or intentions (Hayek, 1968, 180). However, it is in the "permanent interest of all" that some be forced to do something they do not like, such as changing jobs or accepting a lower income (*LLL:3*, 94).

The market yields efficiency, in three senses: products are sold at prices at which buyers will prefer these commodities to other possible commodities; goods are produced as cheaply as anyone knows how; and they are sold at prices as low as any seller is prepared to offer (*LLL:3*, 74). The market is also progressive, because it stimulates innovation (*CL*, 81). While the accumulation of capital makes a contribution to growth, "more probably depends on our learning to use our resources more effectively and for new purposes" (*CL*, 43).

Hayek rejected the possibility of measuring social welfare as the sum of "known particular results". The purpose of using the market is to discover what can be achieved, not the satisfaction of a single hierarchy of ends. In any event, Hayek believed "no meaningful sum can be formed of the satisfactions provided for different people" (Hayek, 1966, 173). The function of the market is to discover what is possible and what is valued. Market process adjusts people's plans to what is possible and to social values revealed by market price, so the values people seek are determined in market process. The outcome of this process is maximum aggregate real income, which on Hayek's view is the only meaningful welfare objective (*LLL:1*, 121 and Hayek, 1966, 173).

The market is a means of social co-ordination. It reconciles competing interests, without recourse to force (*RTS*, 164). The market allows freedom to be realised in a way that maximises progress:

The Great Society arose through the discovery that men can live together in peace and mutually benefiting each other without agreeing on the particular aims which they severally pursue. The discovery that

by substituting abstract rules of conduct for obligatory concrete ends made it possible to extend the order of peace beyond the small groups pursuing the same ends, because it enabled each individual to gain from the skill and knowledge of others whom he need not even know and whose aims could be wholly different from his own (*LLL:2*, 109).

This is a critical step in Hayek's argument. It marries the idea of the market as a knowledge generator and disseminator with the design of the liberal order. The market is politically desirable because it is the means of minimising coercion and economically desirable because of its knowledge qualities. Thus, the rules of a market are the rules of a liberal order and these are the rule of law. The planning measures of the middle way of the welfare state lead to socialism because they do not respect the necessary integrity of the competitive market. Hayek's objection to the welfare state was not its aims, but its methods. The modern welfare state achieves its aims by "a coercive apparatus", which reduces freedom and progress.

2. The Rules for Government in a Liberal Order

The Coercive Role of Government

For Hayek, the aim of policy in a society of free men cannot be a maximum of foreknown results, but only an abstract order:

The aim of policy in such a society would have to be to increase equally the chances for any unknown member of society pursuing with success his equally unknown purposes, and to restrict the use of coercion...to the enforcement of such rules as will, if universally applied, tend in this sense to improve everyone's opportunities (*LLL:2*, 114).

There is no good alternative to improving the abstract order due to its effectiveness in marshalling knowledge and co-ordinating the different plans people have. Government policy is constrained by ignorance and the need to select a single value or hierarchy of values, when no substantive value can be "correct". Government can only assist or make possible the formation of an abstract pattern or structure in which the expectations of individuals approximately match each other, through making each observe rules which are independent of particular purposes.

The role of government is identify and promulgate the rules necessary for the abstract order, whose economic dimension is the competitive market. Thus government economic policy must be known, abstract and uniform, because policy of this kind fosters the competitive market. The principal benefit of such rules is that they reduce coercion as much as is possible (*FC*, 63 and *LLL:3*, 146). The certainty of rules is important for free decisions. The absence of coercion also depends on rules being applied irrespective of whether the effect on particular individuals seems desirable or not (*LLL:2*, 126). The freedom that maximises the chances of the randomly selected individual requires rules that are uniformly applied. The justice of government rules requires it to make available to all on equal terms those facilities which depend on government action (*CL*, 92). Since everyone is required to support government through taxation, all have a claim in justice to a share in the services of government (*LLL:2*, 102). In this way, argued Hayek, rules are most likely to benefit equally anybody's chances.

A competitive market cannot tolerate policies inconsistent with the rule of law. Actions that do not serve the market undermine it. This is the argument first put in *The Road to Serfdom*, and restated in every subsequent work of Hayek. Government must have a monopoly of coercion for the purposes of enforcing these rules, collecting taxes and ensuring national security, and these must be its only monopolies (*CL*, 210 and *LLL:3*, 42). The coercion is justified because it is the best protection against all other sources of coercion. The rule of law reduces coercion as much as is possible, and so should be made as effective as possible. This requires the threat of coercion to the enforcement of the rule of law.

The Non-coercive Role of Government

Government may also do things other than identify, refine and enforce the known, abstract, just rules, collect taxes and secure peace. Hayek stressed that no role is *necessarily* excluded from government, although competition is always preferable if it is possible (*RTS*, 27, Hayek, 1947, 110, *LLL:3*, 42 and *HOH*, 113). Government has a role where effective competition cannot be created for the provision of "valuable" output. Thus, *The Road to Serfdom* supported a significant number of exceptions and qualifications to laissez faire. These exceptions were the source of Keynes' criticism of *The Road to Serfdom* (quoted in Cockett, 1995, 89-90). According to Keynes, Hayek was arguing

that "as soon as one moves an inch in the planned direction you are necessarily launched on the slippery path which will lead you in due course over the precipice". At the same time, said Keynes, Hayek admitted that the practical matter is one of knowing where to draw the line, because the extreme position is not possible. Keynes concluded that this admission means Hayek is "done for", because the argument is then about where to draw the line.

In his later work, principally *The Constitution of Liberty*, Hayek set out rules for the exceptions to laissez faire. The rules were designed to ensure that these cases were consistent with the liberal order. Each must meet four requirements: it must follow the rule of law (*CL*, 221), which means it is compatible with the competitive market, and does not replace the market with planning; second, although consistent with the rule of law, the role must be non-coercive (*CL*, 257 and 284); third, where possible, the role should be *outside* the market (Hayek, 1976a, 306); finally, government must not claim a monopoly of provision (*CL*, 223). If the role can be provided in a way that satisfies these four requirements, whether government should perform the role is then dependant on its "expediency", or whether the "benefits are worth the cost" (*CL*, 222, and see also *RTS*, 28).

3. The Roles of Government

This Section examines Hayek's policy position. According to Gray (1989, 141), Hayek assigned government two policy roles: "the refinement of the institutions and legal arrangements which shape the market process", and "the provision of the goods and services the market will not provide". Further, says Gray, these two roles were justified by Hayek, not on utilitarian grounds, but by their contribution to the working of competitive processes and the prospects of people to participate in market activity. In other words, in Gray's view, Hayek's policy position avoided the "middle way".

The conclusion of this Section is that some government roles and reforms do fit Gray's first category: the roles are designed to contribute to the competitive effectiveness of the market. They are consistent with Hayek's rules for the role of government. This group includes private property rights and competition policy. These also tend to be the cases where Hayek was most clear and consistent about what he believed government should do. There is much less evidence for Gray's view that the provision of goods and services the market

will not provide is to contribute to the competitiveness of the market. There is *some* evidence for Gray's view, in relation, for instance, to the role Hayek assigned government in information provision (see *CL*, 223). However, it cannot be said to be Hayek's rationale for the wide-ranging roles he advocated.

Brittan is closer to the mark, but not entirely correct, when he argues that "[c]ontary to popular belief Friedrich Hayek has not provided any recognisable economic criteria for recognising state intervention of the harmful type" (Brittan, 1983, 63). The criteria are *recognisable*: the problem for Hayek is that the criteria for desirable policy are inconsistent with his rules for the role of government, and do not manage to avoid the "middle way". This group of the roles of government includes an income maintenance scheme, collective goods, education, and town planning. These tend to be the roles where Hayek's proposals were not always clear, and reveal the impracticality of his view about reconstructing the evolutionary tradition to reveal policy needs (*FC*, 69). These are also roles about which Hayek tended to change his position.

The Laws of Private Property and Contract

The most important task of the government is "articulate, interpret and develop" what Hayek called the "private law". Private law comprises private property rights, protection from force and fraud, the rules of contract, and the liability for damages caused to another (*LLL*:2,40). Private law defines the individual domain, ensures the performance of promises and the justice of exchange, gives people the freedom to produce and price at whatever level they choose, and makes people take account of the impact on others of what they do. Market freedom requires a private domain, a sphere within which the individual is free from coercion, and so able to choose his course of action. The private domain is defined by private property rights, though it may include other rights, such as the right to share in government services. For Hayek, property rights are the freedom to acquire and hold property, to choose work and the "reasonable expectations" of the individual about the means that others may use to harm him (*CL*, 145, Hayek, 1966, 167 and *LLL*:1, 103).

For Hayek the rights established by private law are artefacts, not natural rights. They are protected because they are an effective means of securing the freedom necessary for a market: The "recognition of private property is an essential condition for the prevention of coercion, though by no means the only one"

(*CL*, 140), because private property provides *autonomy*. With his private property rights protected, man is free from coercion (*CL*, 20). Private property is also an "inducement" to the individual to contribute as much as possible to the need of all others (Hayek, 1945a, 13).

The content of private law is to be defined and revised as required by the needs of competitive system (*CL*, 229). The most important reform for Hayek was the removal of the special legal position of trade unions (Hayek, 1947, 117). Hayek believed trade unions had become "the only important instance in which governments signally fail in their prime function - the prevention of coercion and violence" (*CL*, 267). The power of trade unions comes from their ability to coerce workers. Hayek believed union action would never be in the interest of *all* workers, because higher wages for some means lower wages or unemployment for others. Unions also distort the market: they create an "inequality which has no function and is entirely the result of privilege", and impose greater uniformity and rigidity of wages in the union sector, greater, non-functional differences between groups and a restriction of mobility. Unionism can produce a de facto authority which replaces market competition (*CL*, 270-3). Unions' role ought to be as voluntary organisations, which provide collective representation of workers, a means of self-government among workers, and a means of self-help through things like friendly societies (*CL*, 276-277).

Hayek considered a number of other issues where he believed reform of the private law was required. These reforms are directed to making the market as competitive as possible (*RTS*, 28-29). Hayek believed patents and copyright unduly extended private property rights and fostered the growth of monopoly (Hayek, 1947, 113-115). Copyright may not be an effective stimulant to effort, and should be confined to "exceedingly useful works" such as dictionaries and textbooks, which "could not be produced if, once they existed, they could be freely reproduced" (*FC*, 36-37). The difficulty is that Hayek did not explain these criteria, so the scope of copyright cannot be determined.

Hayek advocated the reform of corporation law, which he believed had tended to encourage the expansion of the modern corporation beyond what is justified by technology (Hayek, 1947, 116). The main difficulty is the lack of rules assuring that the interests of shareholders are paramount. The apathy and lack of influence of shareholders is the result of institutional arrangements which can

be reformed (Hayek, 1960a). The problems of corporations are problems of the special conditions which the law has created and the law can change. Hayek's suggestion was that the shareholders' problem is that they have no legally enforceable claim to a share of the profits of the corporation. Thus, shareholders should annually be called on individually to decide what part of their share in net profits they are willing to reinvest in the corporation.

"Fugitive resources", which include game, fish, water and oil, raise problems for defining appropriate property rights. The problem is that no one has an incentive to conserve these resources, since what one does not take another will. The problem is that "private property cannot exist" or private property is only beneficial if it is given exclusive control of the resource (*CL*, 369). However, Hayek favoured a system of private property rights rather than "social control". Hayek was never explicit about the way a system of private property rights could be implemented. His argument was confined to the merits of private property compared with government control.

The argument for social control is that government may know things individuals do not and that the social discount rate may be lower, so slowing depletion. Hayek's response was that even if government did have greater knowledge, it is better to disperse this knowledge than centralise it. If the argument about the discount rate was correct it would justify considerable economic planning. However, this is not the case. The market determination of the rate of use of resources is likely to take account of value of future use, because someone will have an interest in this and offer a price based on this. If the price bid exceeds the current price, the stock of the resource will be preserved. Resource conservation is an investment and should be judged by the same criteria as other investment (*CL*, 370-374). Hayek acknowledged there is an act of faith required to accept the market outcome:

In a sense, of course, most consumption of irreplaceable resources rests on an act of faith. We are generally confident that, by the time the resource is exhausted, something new will have been discovered which will either satisfy the same need or at least compensate us for what we no longer have (*CL*, 369).

Less faith is required when the knowledge of the market is marshalled than when a decision is made by government.

Hayek also identified important exceptions to the inviolability of private rights. Private property rights may be suspended in times of emergency, like wars and natural disasters (*LLL:3*, 54). These are examples of "necessary infringements of private sphere". They must be cases where the public gain is greater than harm done by the disappointment of normal expectations, the exceptions must be defined by rule, and full compensation must be paid (*CL*, 217-8). However, these conditions do not satisfy Hayek's rules for the role of government. The first, the excess of public gain over private harm, is a consideration of expediency, which on Hayek's account cannot justify coercion, the second constitutes a break with the generality of rules, and the third is a new consideration, nowhere raised by Hayek in relation to the rule of law.

Competition

Hayek's view on competition policy was rooted in his idea of the market as a means of discovery. The implication of the idea is that it is difficult to frame competition policy because the source of information about economic performance is the market: there is no other source of information about market performance:

If we do not know the facts we hope to discover by means of competition, we can never ascertain how effective it has been in discovering those facts that might be discovered (Hayek, 1968, 180).

It follows that competition policy requires knowledge that authorities are unlikely to have (*LLL:3*, 85). The premise of competition policy is inconsistent with the rationale for adopting competition for resource allocation. This is the argument for competition: we do not know beforehand who will do best nor what is best. It is a discovery procedure for this purpose, and it does so in a way that is consistent with the rule of law. By contrast, competition policy commonly entails discretionary powers, which infringe the rule of law and so are inconsistent with the prerequisites of the free market (*CL*, 265).

There is still a role for competition policy. It is to ensure that the market process is as competitive as possible (*LLL:3*, 68). There are two requirements for a competitive market. There must be no impediments to the flow or transmission of knowledge and there must be low barriers to entry (Hayek, 1966, 174). Barriers to entry must be low enough for there always to be the *threat* of entry. The threat is sufficient to ensure that existing firms are under

competitive pressure (Hayek, 1940, 196). Thus, it is not monopoly as such which is undesirable, but the prevention of competition (*LLL:3*, 83).

Monopolies are caused by economic superiority, government policy and collusive behaviour. There is no role for policy where monopoly is due to economic superiority. This result is simply the market doing what it does best, discovering how to do things efficiently. Although it would be better not to have monopolies, they are an inevitable part of an economy (*CL*, 265). The power to determine price or quality is a consequence of private property, and cannot be eliminated without abandoning private property. Neither size nor ability to set prices is a measure of harmful economic power. There is no economic standard for determining if a firm is too large (*LLL:3*, 77) Much enterprise monopoly is the result of better performance. Sometimes competition has done its best when it yields a monopoly (*LLL:3*, 73). So we must allow the monopolist the possibility of a monopoly profit. If there is no entry in these circumstances, this suggests that the monopolist is performing better than any potential entrant could. However, where monopoly is due to a government policy, then that policy should be changed to remove its monopoly result. The most effective policy is to deprive government of the power of benefiting particular groups or interests (*LLL:3*, 82). This would occur if government were bound by the rule of law.

The situation is different where market power is used to prevent others from serving customers better (*LLL:3*, 72). What is harmful is the ability of a monopolist to preserve its position after its source of superiority has gone (*LLL:3*, 84). The problem Hayek identified was collusive action (*LLL:3*, 90). Hayek suggested a number of ways for government to check collusion. One is the dissemination of information, for the "real issue is how we can best assist the optimum utilisation of the knowledge, skills and opportunities to acquire knowledge" (*LLL:3*, 68) - "there is no doubt that the utilisation of knowledge can be greatly increased by deliberate efforts" (*CL*, 376). His proposed reform of patents and copyright arrangements were relevant here, as well as the information responsibilities assigned to government in relation to collective goods (see below). Potential competitors could be used as watchdogs on performance by being given a remedy against price discrimination, such as a claim of multiple damages, and all agreements in restraint of trade could be declared invalid (*LLL:3*, 85-87).

There may be cases of what Hayek called "inevitable" monopoly, such as railways, road and air transport, and the supply of gas and electricity (*RTS*, 146). The policy issue is then a choice between the freedom of a market with no legal monopoly rights and the greater abundance of a market supplied by a producer with monopoly rights. The interesting feature of Hayek's discussion is that it was not conducted in terms of the undesirability of a monopoly, because of its reduction of freedom and its inconsistency with the rule of law, but in terms of a social judgement to be made on the merits of the alternatives. The benefit of freedom is that it stimulates (but does not guarantee) progress. Where society chooses to confer monopoly rights, Hayek's preference was for government supervision of private monopolists. Private monopoly is "scarcely ever complete and even more rarely of long duration or able to disregard potential competition" (*RTS*, 146). By contrast, government monopolies make competitive experimentation impossible and so prevent selection by evolution (*FC*, 103). Hayek expressed a preference for the control of monopolists through "stringent price control". He expected that this would make monopoly unattractive to entrepreneurs, who "will rediscover their taste for the bracing air of competition!" (*RTS*, 147). This expectation sits uncomfortably with his concern about the tendency to collusive action (*LLL*:3, 90).

Stabilisation

Hayek changed his mind about stabilisation policy, but did not change his mind about Keynes' views. Hayek's critique of Keynes was that Keynes started from the correct insight that the cause of unemployment was real wages being too high, but Keynes' response was incorrect. Keynes' argument that it was easier to reduce real wages by monetary expansion rather than a reduction in money wages was incorrect. Keynes was "naive" to think that workers would be deceived for long, and that the lowering of the purchasing power of money wages would not generate demands for higher money wages to compensate, "demands which would be even more irresistible when it was recognised that they would not be allowed to have any effect on employment." (Hayek, 1959, 282). In addition, the stimulating effect of inflation only occurs when the inflation is unforeseen (*CL*, 331). This means an increasing rate of inflation, which is not sustainable, due to the decline in income in the investment goods industries (Hayek, 1959, 282). The consequence of Keynes was that government assumed responsibility for full employment, which it could not deliver without also increasing inflation. But by taking this responsibility,

government relieved trade unions of the responsibility for taking account of the unemployment consequences of wage settlements (*CL*, 280).

The second error in Keynes was, according to Hayek, the emphasis on macroeconomic measures.

Economic activity is not guided by totals but always by relations between different magnitudes, and the practice of always thinking in 'global' totals can be very misleading....Much of the confusion about the effects of wage reductions has been caused by the fact that Keynes himself was always thinking in terms of a general wage cut, while the argument of his opponents was in favour of allowing some wages to fall (Hayek, 1952, 347).

The causes of unemployment often lie in imbalances in particular markets. Significant unemployment is often confined to particular regions or industries, due to a discrepancy between the distribution of resources and the distribution of demand. So the problem is one of inappropriate relative prices and wages. In those cases, additional expenditure may not create additional employment. Only a reallocation of resources in response to revised prices and wages solves the problem in a free economy (Hayek, 1950, 271-2 and Hayek, 1972, 201). Here the idea of market re-emerges. The only way to secure full employment is for the distribution of labour to be consistent with the needs of the market, and this cannot be known beforehand. It is something to be discovered by letting the market do its job (Hayek, 1950, 275).

Hayek's own explanation of unemployment changed. Trade cycles were the subject of two of his earliest works, *Monetary Theory and the Trade Cycle* (1933) and *Prices and Production* (1935), but the theory developed in these two works to explain general unemployment became part of an explanation of structural unemployment. In his 1950 paper "Full Employment, Planning and Inflation", Hayek drew on his trade cycle work to argue that the distribution of labour between capital goods and consumer goods production will be inappropriate during a boom. The solution is to allow a market correction via changes in relative wages (Hayek, 1950, 273). The stress in the subsequent work was that a market economy will always generate unemployment as a consequence of change. This unemployment will be structural. The booms and troughs of the economic cycle generate more than usually severe unemployment, but the source of that unemployment is a structural imbalance between consumption and investment goods. Hayek discounted the importance

of general unemployment - the kind Keynes had been addressing - and appears to attach no importance to the role of effective demand, to which Keynes gave so much emphasis.

The structural unemployment that change produces is due to the freedom of workers. So long as workers have the freedom to choose their work, there will be delays in the adjustment process and so some unemployment. Workers will initially exercise their freedom by resisting the change, and this will lead to some of them becoming unemployed. A monetary expansion can serve to keep some in their jobs for longer than they otherwise would be. However, in the long run it becomes self-defeating and serves only to hold up the reallocation of labour made necessary by the changes in the market. The result is lower labour productivity and an increase in "the proportion of the working population which can be kept employed at present wages only by artificial means" (*RTS*, 154). The policy dilemma is that if credit expansion stops, unemployment would be greater than it would otherwise have been (Hayek, 1950, 273).

The major shift in Hayek's position was in relation to his views on monetary policy. In *The Road to Serfdom* Hayek had endorsed the use of monetary policy and (more cautiously) public works to combat unemployment (*RST*, 90-91). Six years later, he expanded on this simple endorsement by arguing that where there is general unemployment in the sense that resources of all kinds are unemployed, then monetary expansion is beneficial (Hayek, 1950, 271-2). In the *Constitution of Liberty* his position was that government should try to reduce cyclical unemployment as much as possible by monetary policy (*CL*, 302). This would preserve the impersonal method of market adjustment where people can choose their occupation. However, government should retain control of monetary policy, because business has come to rely on existing forms of money and credit, and monetary policy can reduce unemployment (*CL*, 324). The best monetary policy is one which follows a mechanical rule set according to long run considerations (*CL*, 333). The objective of monetary policy should be a stable price level, which is the best means to a high and stable level of employment (*CL*, 337).

Hayek's final position was to argue for the denationalisation of money combined with a fixed exchange rate, a position he had first suggested in a footnote in *The Constitution of Liberty* (*CL*, 520, note 2). Hayek proposed that governments should give up the monopoly of their own currencies in regard to

legal tender, and should allow private contracts to be made in terms of any other currencies. Government had abused the monopoly power of issuing money, and a competitive market of private moneys would be a more effective check on inflation, because people would seek out the most inflation proof currency (Hayek, 1991). Hayek's argument for fixed exchange rates was that they constitute a "discipline on governments" (*HOH*, 150). The monetary rule Hayek proposed in *The Constitution of Liberty* represented an effort to find a rule of law for the market. Hayek felt the monetary rule had failed because it was too vulnerable to discretionary abuse by government. It was preferable to remove the monopoly of the issue of money from government to eliminate discretionary abuse. Hayek's difficulties with the monetary rule reflect the inadequacy of his concept of acting correctly by being bound to follow known, general and abstract rules. More is required to restrict government from acting inappropriately than being bound by the rule of law.

Minimum Income Scheme

Hayek advocated an income maintenance scheme which provided "a constant minimum for everybody who cannot earn more than that minimum in the market" (*HOH*, 149). This minimum should be "more than is absolutely necessary to keep alive and in health" (*CL*, 285). It should be available to anyone who experiences misfortune from the risks "which are common to all".

A minimum income scheme is a "clear moral duty" (*LLL*:2, 87), and a "necessary part of the Great Society". It is necessary in a large society where people do not have the private help of others, and it is possible in a prosperous community (*LLL*:3, 55). The level of protection depends on community prosperity, that is, the ability of the community to pay (*CL*, 101). Because of the uncertainty of "the common hazards of life", "few individuals can make adequate provision" against them, a problem of market failure. Insuring against these risks does not generate problems of moral hazard, so there is a very strong case for government "helping to organise a comprehensive system of social insurance" (*RTS*, 90).

As a "recognised duty of the public", insurance would have to be compulsory (*CL*, 286). In addition, Hayek justified coercion on the basis that otherwise non-payers would become a charge to the public and because it forestalls greater coercion of the individual by those suffering "extreme misery" (*CL*,

286). Each of these reasons for coercion is inconsistent with Hayek's justification of assigning government the power to coerce, which was the enforcement of the rule of law, taxation and defence. The rationale for the scheme is the moral obligation of a large, prosperous community to assist those who experience misfortune, and the inability of the market to generate adequate insurance arrangements. The considerations are a notion of social duty, a practical element of self-protection, the ability to pay, and a problem of market failure. The scheme is not justified by its contribution to the functioning of the competitive order. The coercion could only be justified by Hayek on the basis that the minimum income scheme contributes to the abstract order, but he did not make this case.

The temptation is to establish a government monopoly, for this would have universal coverage and economies of operation. The economy of operation may be true in the beginning, but in time a monopoly would become inefficient (*CL*, 287). The alternative is for the evolution of "suitable institutions". Although this takes time, and means some will miss receiving the benefits of protection, it is the preferable route. It can be accepted that government should not exclude private providers, as Hayek implicitly argued, but it is very difficult to envisage a private provider being viable. This is because benefits would have two parts: those the individual has paid for and those being given because of need (*CL*, 288 and 293-295). The payments of benefits according to need suggests there must always be some role for a public agency in the provision of the safety net.

Hayek rejected any "deliberate redistribution beyond" the provision of a safety net (*HOH*, 149). Such a policy requires unequal treatment of people, because it represents particular benefits for specific individuals, which can never be just, and is inconsistent with the rule of law (*LLL:2*, 142). By requiring discretionary judgement by authority, it "suspends" the market (*LLL:2*, 87), which has "brilliantly" reduced absolute poverty: relative poverty must always exist outside of any completely egalitarian society (*LLL:2*, 139). In addition, the poor have no moral claim for a greater share of the wealth of society. The wealth of a community "may set a standard for what some ought to be willing to give, but not for what anyone can demand" (*CL*, 101). Finally, increasing the security of one group necessarily reduces the security of the rest, because the share of fluctuations they bear must increase, and "the essential element of security which the competitive system offers, the great variety of opportunities, is more and more reduced" (*RTS*, 95).

In Hayek's view, the market game increases the chances of all of a high real income, and this, plus the assurance of a minimum income *outside* the market, "leaves no moral justification for a use of force to determine relative incomes" (*LLL:3*, 142). Hayek distinguished the minimum income proposal from any deliberate redistribution "beyond that" on the basis that his scheme was *outside* the market, whereas other schemes distorted the market (*LLL:2*, 87). But it is not clear that a rule, which specifies people's eligibility according to certain misfortunes, is any different from a rule which specifies people's eligibility according to other defined events, like "structural adjustment". This is the problem of specifying a general rule, and indicates that Hayek's insistence on the generality of a rule is an impractical notion, because it avoids the question of how the categories to which the rules apply are to be specified. Nor is it clear that an entitlement to a minimum income in the event of misfortune is outside the market, whereas any other income entitlement in specified circumstances "beyond that" is "inside" the market and a distortion of it.

Health

Hayek agreed there is a case for compulsory health insurance exactly as for social security income insurance, but there are also some "peculiar" problems with health (*CL*, 297). Hayek objected to a government monopoly of health insurance and a free health service. He believed that the safety net should comprise only income, and not the provision of goods or services in kind, such as free health (*HOH*, 149). In addition, the case for free health is based on the erroneous "belief that medical needs are usually of an objectively ascertainable character and so can and ought to be fully met without regard to economic considerations"; and the incorrect idea that this is economically possible because improved medical services improve economic efficiency (*CL*, 298).

Health care requires resources like anything else, and decisions about health care resource use require information about value. Somebody must decide whether resource use is justified. The question is whether this decision should be made by the individual or by somebody else (*CL*, 299). Hayek's suggestion was that it should be the individual: this would mean those who can return to work would have priority over the aged and mortally ill. This "may seem harsh, but it is probably in the interest of all" (*CL*, 299). A public health system constitutes a monopoly insurer and supplier, and as such impedes progress of

medical science. "[C]ompetition is an essential condition of progress" in medical science as much as it is anywhere else (*HOH*, 149). Nationalisation of medicine makes doctors employees of the state, and this means a potential loss of the patient's privacy in relation to government (*CL*, 300).

The interesting issue in Hayek's discussion of the "peculiar" problems of health is that it did not take account of the potential problems of market failure due to patient ignorance. Hayek may be excused from this omission because this idea was not well-known in 1960 when he wrote *The Constitution of Liberty*, although, for instance, Marshall had identified it as a case for government regulation of medical practitioners (Marshall, 1927, 638). In addition, consumer ignorance is a rationale for a government role in education in *The Constitution of Liberty* (*CL*, 376-377). More generally, it is interesting that Hayek's stress on individual knowledge did not lead him to think more about individual ignorance. This may have been because his perspective was society's utilisation of the incomplete knowledge of the individual by the market aggregation of dispersed knowledge. However, there may be cases, like health care, where the knowledge of patients is inadequate and its aggregation would still leave that knowledge inadequate. More generally, as with his discussion of the minimum income scheme, Hayek was much clearer about the elements of the English National Health Service he objected to than he was about what he thought policy should be.

Collective Goods

Hayek recognised that there are goods the market may not provide at all or not provide in sufficient quantities. He called these goods collective goods. Hayek's understanding of what constituted collective goods changed markedly. In the 1944 work, *The Road to Serfdom*, he identified the need for collective goods as occurring where there is an "important" "*divergence between the items which enter private calculation and those which affect social welfare*" (*RTS*, 29 - emphasis added). The problem is the absence of property rights in external benefits and costs. In these cases, "some other method than competition may have to be found." Hayek's examples of this Pigovian concept were signposts, roads, deforestation, some methods of farming, smoke, and noise (*RTS*, 29), and knowledge, information and mobility (*RTS*, 71).

In the 1960 work, *The Constitution of Liberty*, Hayek shifted the emphasis of the concept of collective goods. There he argued, following the concept of public goods introduced by Samuelson and Musgrave, that it is

essential for government to provide all those services which are clearly desirable, but would not be provided competitively because it is *impossible or difficult to charge the beneficiary for them* (*CL*, 223 - emphasis added).

The examples Hayek cited were sanitary and health services, construction and maintenance of roads, municipal urban services, public works, military preparations, and the advancement of knowledge; things which facilitate the acquisition of reliable knowledge about facts of general significance, including a "reliable and efficient" monetary system, standards of weights and measures, surveying, land registration, and statistics (*CL*, 223). There is another group of cases as well, comprising natural parks, museums, theatres and sports grounds. According to Hayek,

there can be no objection to the government providing such amenities...so long as the community approves this, in full awareness of the cost, and realises that this is one aim competing with others and not a unique objective overriding all other needs. If the taxpayer knows the full extent of the bill he will have to foot and has the last word in the decision, there is nothing further to be said about these problems in general terms (*CL*, 375).

In *Law, Legislation and Liberty* (1976) the concept of collective goods changed again, as did the examples. For the first time Hayek used the term collective goods synonymously with public goods (*LLL*:3, 44). The discussion of collective goods emphasised the difficulty of confining benefits to those willing to pay for their costs (*LLL*:3, 43). There was also the problem of consumer ignorance, reducing the demand for knowledge below what would be socially beneficial. There is a case on this ground, and the low cost of the reproduction of information, for information to be free (*LLL*:3, 60). The government's monopoly on the issue of money was removed from the category of collective goods (*LLL*:3, 148). Long distance roads, on which tolls could be levied, were excluded as collective goods, but quality certification was included (*LLL*:3, 44). The justification for quality certification was to "facilitate" consumer choice, which would improve the "working of the market". The ambit of quality certification was extraordinarily wide:

Building regulations, pure food laws, the certification of certain professions, the restrictions on the sale of certain dangerous goods (such as arms, explosives, poisons and drugs), as well as some safety and health regulations for the processes of production and the provision of such public institutions as theatres, sports grounds, etc., certainly assists intelligent choice and sometimes may be indispensable for it....All that is required for the preservation of the rule of law and of a functioning market order is that everybody who satisfies the prescribed standards has a legal claim to the required certification, which means that the control of admissions authorities must *not* be used to regulate supply (LLL:3, 62).

Whatever their precise meaning, Hayek was always clear that collective goods contribute to welfare. They are part of the society's quality of life. Many of them, like parks, museums and theatres, are close to being merit goods. They could not be considered as contributing to the competitiveness of the market, and were not so justified by Hayek. Hayek spoke of the "right" to share in collective goods being an "important part of the protected sphere of the individual" (CL, 141), which was a significant extension of Hayek's notion of the protected sphere as a prerequisite to the market.

The provision of a collective good is subject to two criteria. The first was a consistent position of Hayek: the collective good must be supplied subject to the rule of law. Hayek's first preference was for government to fund provision but to leave supply to the private sector (CL, 224). Second, in *The Road to Serfdom* and *The Constitution of Liberty*, the benefit of the collective good must exceed its cost. This is the test of "expediency" (RTS, 28 and CL, 222). In *Law, Legislation and Liberty*, this criterion was replaced by a test of whether the good itself satisfies the defined requirements of a collective or public good (LLL:3, 43-44). The term expedient took on a pejorative meaning in *Law, Legislation and Liberty*, where it was used to describe the practice of making decisions based on the merits of the case, and thereby sacrificing the principle of freedom (LLL:1, 56). This change left open the question of how decisions would be made about which public goods to supply.

The provision of collective goods entails coercion, because they are funded by taxation, but they are not equally available to all, and so are "unjust" in Hayek's sense (LLL:1, 139), and inconsistent with the rule of law. Significantly, Hayek did not use the presence of coercion as a ground to argue against the public provision of infrastructure. His solution was that

So long as each may expect to get from this common pool services which are worth more to him than what he is made to contribute, it will be in his *interest to submit to the coercion*. (LLL:3, 45 - emphasis added. See also LLL:2, 6-7)

However, the individual may see his interest differently, or may not want to submit to coercion. Hayek's endorsement of coercion sits uncomfortably with the central value of freedom.

The other difficulty is the vagueness of the test of "expediency". Hayek rejected the idea that people's welfare can be compared or added up, and this seems to exclude any Cost-Benefit Analysis evaluation of goods not provided by the market. Expediency is a matter of whether "it is thought worthwhile". For instance, Hayek cautioned against regulating the method of production, because such rules limit experimentation and raise the cost of production. "But if this effect on cost is fully taken into account and it is still thought worthwhile to incur the cost to achieve a given end, there is little more to be said about it" (CL, 224). Similarly, while the rule of law excludes government from making decisions about who will produce, and at what prices and quantities, it does not exclude admitting to certain occupations only those with specified qualifications (CL, 227). The practical problem is that of determining what those qualifications should be without making a judgement about merit, which would violate the generality condition. Interestingly, the examples of this entry restriction in *The Constitution of Liberty* were the control of the sellers of poisons and firearms, which in *Law, Legislation and Liberty* was a matter for the restriction of sales (LLL:3, 62).

Education

Market intervention in relation to education is required for two reasons. The first is the problem of consumer ignorance. Children cannot make informed decisions and parents may not make decisions in the children's best interests. For adults, education may awaken capacities they did not know they had (LLL:3, 61). Hayek advocated compulsory general education for all, with government financial assistance for families that could not afford compulsory education. The case for coercion is that the catallaxy is stronger if everyone shares some basic knowledge and values (CL, 377), though the "conquest of ignorance" will not initiate a new era, as Mill had hoped it would (CL, 378). If all families are compelled to send their children to school, then the community

should pay for those families to whom the "cost would be a severe burden" (CL, 378).

Hayek supported a voucher system to avoid a government monopoly of the provision or control of the content of education, which would be dangerous for freedom due to its power over men's minds (CL, 380-381). He suggested that government schools could be confined to cases of small isolated communities where the numbers of children are too small for the economic provision of private education (CL, 381). This case in favour of private education is despite his view that inculcating shared values is a case for compulsory education. The period of compulsory, publicly funded education depends on the prosperity of the community, the character of the economy, and the "climatic conditions affecting the age of adolescence" (CL, 382).

Hayek's presumption was that higher education should focus on a "comparatively small elite" (CL, 382). Advances in knowledge depend on research, and increasingly, Hayek felt, fewer universities were doing this. This was due to the universities' "utilitarian bias" for conferring professional qualifications, and the "democratic preference" for better material opportunities for large numbers over the advancement of knowledge. In order to advance knowledge, universities should not provide what customers demand (CL, 389). Hayek proposed subsidy assistance for general education and cases where the contribution the education generates becomes freely available to all, and is not reflected in the price scientists and scholars receive for their services. This, therefore, excludes vocational and professional training from subsidies, which the individual can fund by loan arrangements, despite their practical difficulties (CL, 382-383).

The entry of students to higher education should not be by the "subjective merit" of "effort and sacrifice", but capacity and aptitude (CL, 385). Those who display the greatest ability should be allowed to develop their talent irrespective of family means, though how ability is to be determined is extremely unclear (CL, 386). This means certain advantages are to be limited to some, which may be "unfair", but making the best use of the "accidents of the environment", which includes some having more ability than others, is the source of the "growth of civilisation" (CL, 385). Having all start with the same chances is "literally impossible to realise" (CL, 385), and undesirable, because it would

tend to repress the ability of people to take advantage of their "unfair natural gifts" and "opportunities", which are the source of progress (CL, 388).

According to Hayek, a policy of equality of opportunity, which increases the chances of some, may mean reducing the chances of others (CL, 386), even though he also argued that the market game of skill and chance is not a zero sum game. The fact that it is not a zero sum game may mean that equality of opportunity may increase the chances for some, without reducing the chances of others. The other issue is that Hayek overemphasised the role of chance. He believed that "success must to a great extent be a matter of chance" (CL, 388). There is also a relationship between skill and reward, as there is between social position and skill and the matters of chance which bring success.

Town Planning

The first recognition by Hayek that competition does not "adequately solve" the problems created by a town was in *The Road to Serfdom* (35), and developed in greater detail in *The Constitution of Liberty*, where it was recognised that a significant number of the costs of city life are "communal" (341). Whereas with "mobile property" the advantages and disadvantages accrue to the owner, the use of land "often necessarily affects the usefulness of neighbouring pieces" (CL, 349). The value of land reflects the uses of neighbouring land and the services and regulations of authorities, and economic decisions require that these effects be taken into account (CL, 349). Hayek's argument was that the market should be retained, because of its effectiveness in mobilising private initiative and dispersed knowledge and foresight, but that a more detailed "framework of rules" is required (CL, 350). Town planning establishes the

general conditions to which all developments of a district or neighbourhood must conform, but which, within these conditions, leaves the decisions to the individual owner [and makes] the market mechanism more effective (CL, 350).

Essentially, Hayek's approach was to internalise the externalities by increasing the size of the planning unit from the private property owner to the community (CL, 351-352).

The problem of town planning is that planning measures will increase the values of some property and reduce others. To ensure a measure is beneficial, gains must exceed losses. The practical problem is to measure the costs and benefits. Hayek accommodated this problem by making the planning authority responsible for the gains and losses, so that it could capture the benefit of increases in value and compensate those whose property value has suffered. The means is the power to expropriate at "fair market value" from those who oppose the measure. So long as this is the only coercive power, it is acceptable because of the obligation to compensate at "fair market value", and provided disputes are only settled by "independent courts", meaning that planning authorities have no discretionary power (*CL*, 351).

Once again, compensation was used to justify coercion, even though such compensation was not part of Hayek's general rules for the role of government. In addition, Hayek ignored the practical difficulty of determining the impact of a planning measure on property value, even though a recognition of this kind of problem was part of his strong attack on the British Town and Country Planning Act (Hayek, 1949a, 334).

Taxation

Taxation is an allowable coercion by government, providing it is exercised in accordance with the rule of law. However, Hayek was strongly critical of progressive income taxation. There were four elements to this view. First, progressive taxation abandons the principle of equality before the law (*CL*, 310). It constitutes an invalid coercion of the rich, even though the rich can "survive" under progressive taxation, which would suggest that on Hayek's test of coercion that progressive taxation is not coercive (*CL*, 136). For Hayek progressive taxation was a distributional decision imposed by a majority, which violates the rule of law (*CL*, 311). Second, it interferes with the working of the market. Progressive taxation limits the ability of successful people to accumulate a fortune. This impacts adversely on investment and technical progress, the allocation of resources, incentives, and reduces social mobility by making it "practically impossible" for a successful man to rise by accumulating a fortune (Hayek, 1947, 118 and *CL*, 308). Third, it eliminates an important part of a free society, the man of independent means (Hayek, 1947, 118). Fourth, the "scientific" argument in favour of progressive taxation, the decreasing marginal utility of consumption, is flawed. This is due to the

difficulty of comparing utilities between people, and because it is doubtful whether the concept of decreasing marginal utility has any meaning, if "we count as income all the advantages a person derives from the use of his resources (*CL*, 309).

Hayek advocated proportional income taxation. It is consistent with the rule of law because all are treated equally. It is also a rule all people, "those who will pay absolutely more and those who will pay absolutely less", are likely to agree on (*CL*, 314). There are four difficulties with Hayek's proposal, which also relate to his criticisms of progressive taxation. As a longstanding system of taxation, progressive taxation may be said to constitute an "ingrained moral belief", in which case it is an appropriate abstract principle for the rule of law to embody. Second, progressive taxation is consistent with Hayek's rule of law, interpreted in the sense in which he uses the concept in cases like control of occupational entry - there may be a different rule for a group with special features. Third, as Viner points out, "proportional taxation of income means regressive taxation of property,...and at present levels of taxation proportional taxation of income rigorously adhered to would mean starvation for many (Viner, 1961, 351). Finally, there is the problem of the incompatibility of Hayek's objections to progressive taxation and his support of a minimum income scheme and government funding of general education. The funding principle of the income scheme and education is the community's ability to pay. Their rationale is a form of vertical equity, by providing specific assistance to those who suffer misfortune under the minimum income scheme and assisting families not able to pay for compulsory education.

4. Conclusion

Hayek's system comprised the value of freedom, the idea of the market as an efficient means of solving the knowledge problem, and the policy position that freedom and the market are best promoted by a government which identifies and enforces the rule of law, and is itself bound by the rule of law. This is Hayek on a minimum, but active, government. And yet, as this paper has shown, Hayek advocated a significant set of policies which went beyond what was necessary for a properly functioning competitive market.

Hayek on policy often discarded elements of his "constitution of liberty", depending on the merits of the situation. In some cases, like income

maintenance, values other than freedom constituted the goal of policy. The commutative justice of the market, which Hayek argued strongly was a consequence of freedom and necessary for the efficiency of the market (Hayek, 1940, 203, 1946, 21-22, and 1963, 258), was qualified by a scheme which cushions people against errors and misfortune. Hayek advocated the sacrifice of an amount of market freedom for a gain in social welfare. In others, like education, ignorance by consumers justified regulating the market by making schooling compulsory. Coersion was justified by consumers' tendency to underestimate the benefits of education. The work of universities should not be driven by the market, despite Hayek's view that the market is the only source of information about social value. The notion of collective goods was broadened considerably by Hayek in a way that reflected the development of the ideas of public and merit goods from Pigou to Musgrave. However, adoption of a Musgravian notion of public and merit goods funded by taxation created difficulty for Hayek's concept of coersion. Hayek's choice between extending public goods or limiting public goods but preserving the rule of law was to choose the former and qualify the meaning of coersion and the rule of law.

Keynes' observation that for Hayek the practical issue of policy is where to draw the line, leads to the idea presented in this paper there there were two Hayeks on government. The presence of two views on government constitutes an inconsistency in Hayek's position. It also reveals the difficulty of designing a "constitution of liberty" which provides a workable policy framework. Hayek's policy views show the problems of confining policy by a permanent set of rules. Contrary to Hayek's purpose, his policy position reveals the impacts of new ideas, social values other than freedom, and historical circumstances, and a reliance on comparisons of costs and benefits in policy making. These are elements of time and place, and judgements about merit, which elude efforts to confine policy to a set of rules for government.

NOTE ON CITATION PRACTICE

The following abbreviations are used for the most commonly cited Hayek texts.

Hayek on Hayek: HOH
Law, Legislation and Liberty: LLL
The Constitution of Liberty: CL
The Fatal Conceit: FC
The Road to Serfdom: RTS

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