



F. A. HAYEK

## Friedrich August von Hayek 1899–1992

HAYEK WAS BORN IN VIENNA on 8 May 1899 and died in Freiburg in Breisgau, Germany on 23 March 1992. He came from that extraordinary background in educated Viennese society which has produced some of the greatest names in twentieth-century intellectual history including not only Hayek himself but also Popper, Wittgenstein and Mises. Indeed Hayek was related to Wittgenstein, and wrote some reminiscences of his dealings with him although, like some others, he seems to have had considerable doubts about the philosopher's mental stability (*Collected Works*, vol. IV (1992), pp. 176–181.) Hayek's own family background was firmly academic — one brother became Professor of Anatomy at the University of Vienna, and another became Professor of Chemistry at the University of Innsbruck (F. Machlup *Essays on Hayek* (1976), p. 13). Hayek's father was Professor of Botany at the University of Vienna; and after education at that institution Hayek entered the Austrian Civil Service in which he spent the years 1921–6.

Hayek soon came under the influence of Ludwig von Mises and it was Mises who was to prove probably the most decisive single influence on Hayek's intellectual development. Hayek has left an account of this association (*Collected Works*, vol. IV (1992), pp. 25–30) which gives some insight into the extraordinary intellectual vitality of Mises, forever condemned to be an outsider yet of enormous influence. There were, it is true, significant differences of personality; Mises was much the more combative — even aggressive — and Hayek much the more

scholarly and retiring. They shared an indomitable intellectual and moral courage; but Mises often showed little patience with opponents whereas Hayek went almost too far in the opposite direction in his tolerance of would-be petty totalitarians — this stands out particularly in his writings on legal philosophy.

One of Hayek's greatest contemporaries has paid tribute to this open-mindedness and patience. In his Memorial Address for Hayek at LSE in September 1992, Sir Karl Popper said:

Hayek's openmindedness was one of his most striking virtues. He was, as you know, an anti-socialist. But he took great trouble to convince communist and socialist students that they were welcome in his lectures and seminars; and they found, indeed, that he was ready to listen to them with sympathy. In this respect I had to learn a lot from Hayek, for I was far less ready to listen to ideological clichés than he was. Hayek's tolerance was indeed exemplary; and as far as students were concerned, he behaved with convincing tolerance, even to those who preached intolerance.

This patience was itself the result of a deliberate decision on Hayek's part to recognise that 'the foundations of totalitarian barbarism have been laid by honourable and well-meaning scholars' (*Law, Legislation and Liberty*, vol. I, p. 70).

The slightly self-effacing aspect of Hayek's personality, which appears to have become more marked over the years, seems to have led to a measure of neglect of his work. There was indeed a time in the 1960s when Hayek's influence appeared to be retreating into the shadows. The painstakingly written work, patiently assembling a scholarly canvass, was not calculated to win converts. At the same time, in the *chic* leftishness of academic circles in the 1960s, the more juvenile seemed to think that they had established that Hayek was some kind of Nazi because of the 'von' in his name — thereby demonstrating not only an ignorance of the significance of this prefix but also of the Nazis themselves and, for good measure, of the fact that Hayek had been a naturalised Briton since 1938.

Hayek's work spans both economics and philosophy (and even psychology) in a way totally outside the experience and training of modern economists. As Sir John Hicks wrote, perhaps rather teasingly, in the preface to his *Critical Essays in Monetary Theory*, 'Professor Hayek . . . has turned from economics to social philosophy, but may sometimes be available for consultation'. It is however noteworthy that Hicks, in the 1960s when Hayek's star appeared to be in danger of eclipse, should have felt it worthwhile to try to disentangle Hayek's

monetary model. For Hayek came to this country as an economist, and he participated vigorously in the economic controversies of the 1930s. His transmutation into an economist/philosopher, though perhaps immanent in the crucial Misesian influences, has its roots in the key to his moral standard. This key was the emphasis upon freedom — not merely freedom for the individual, but freedom for society to respond to the needs of its individuals in such a way as to allocate resources optimally and, perhaps even more importantly, to evolve and to develop new social forms.

Another extremely important factor in Hayek's development was a passionate belief — shared with Keynes — in the importance of ideas *per se*. Though Hayek never held office, and never sought the ear of the powerful of the day, he believed that ideas had an enormous influence upon the conditions experienced by the individuals whose freedom constituted the ultimate moral standard. Frequently the effects of these ideas could be disastrous. It was because of this danger that Hayek became the most scholarly and outspoken opponent of 'scientism' (the naïve belief, espoused by even distinguished scientists, that society could be operated like a factory) and was outspoken in his critical account of the force of ideas in German history which laid open the way for Hitler. Ideas influenced politicians and journalists but their role within the educational establishment — especially in the promulgation of historical myths such as the conventional view of the Industrial Revolution — was particularly important.

Hayek was extremely well fitted, both by temperament and background, for a scholarly life devoted to the examination of such ideas. Educated in the great Austro-German tradition of scholarship, he was able to compensate for the narrowness of his original education by the attention which he paid to a wide range of scholarly sources. This was very much a part of the Austrian tradition; Böhm-Bawerk's great work on capital (1884–9) is in fact two separate works, the first of which surveys, exhaustively, the previous literature on capital, before Böhm, in the second volume, launches into the development of his 'Positive Theory'. Similarly when, in the late 1920s, Hayek began to write a major work on monetary theory (left incomplete because of the rise of the Nazis) he approached it via a study of the history of monetary thought, developing an extremely impressive knowledge of the literature in several languages. This work (though made available to other scholars in the interim) did not see the light of day for many years (*Collected Works*, vol. III (1991), pp. 127–244). Like Menger, the

founder of the Austrian school, Hayek lectured on the history of economic thought (in his case, for more than four decades) and, again like Menger, was a remarkable bibliophile who, as I can testify from my own experience, was extremely generous with his books even when he knew nothing of the potential user.

Hayek read widely, deeply, and, it seems, continuously. Sir Karl Popper in his Memorial Address of September 1992 recounts how he delivered a copy of *Logik des Forschungs* to Hayek at their first meeting in 1935. Hayek promised to read it and to be ready to discuss it at their next meeting in a week's time; and he was as good as his word. Popper said 'I know of no similar story, and it is characteristic of this man, of his intellectual honesty. Authors of non-fiction books will agree with me that this story is unique.'

Hayek's erudition was remarkable; as anyone dipping into his great *Law, Legislation and Liberty* quickly discovers, his citations range over centuries and countries in a way which has no parallel amongst modern economists. He seems to have had a detailed knowledge of economic literature in German and English — this perhaps to be expected — and a very considerable knowledge of Italian, French, and medieval Latin texts.

This scholarly tradition compensated, at least to some extent, for a training in economics which, as became apparent with the republication in 1984 of his early essays as *Money, Capital and Fluctuations*, was distinctly narrow. It seems to have been based very largely on the work of Menger, Wieser and Böhm-Bawerk, particularly that of Wieser, and later interpreters of this work within the narrowly Austrian tradition, notably Mayer and Strigl. It was really Mises — himself something of an outsider in Vienna because he managed to be both Jewish and non-socialist, and, as Hayek explained (*Collected Works*, vol. IV (1992), pp. 128n, 157), you could secure advancement if Jewish if you were at the same time left-wing — who substantially broadened Hayek's outlook and introduced him to a much wider range of literature. Even more importantly he seems to have alerted Hayek to the full possibilities of Austrian economics, and to the much wider considerations implied by Austrian subjectivism and the Austrian aversion to partial equilibrium analysis. When Hayek came under the influence of Mises he was, according to his own account, a mild socialist; it was Mises who opened his eyes to the fundamental and inherent contradictions in the pretensions of those who believed that man could plan and direct society (*Collected Works*, vol. IV (1992), pp. 133, 136). He did so by

bringing home to Hayek the full force and subtlety of the Austrian approach to subjectivist general equilibrium, an approach essentially originating with Wieser but one enormously expanded by the 1920s Austrian writers. Thus fired, and fired moreover by one whose own work showed very considerable knowledge of the British literature, Hayek broadened his reading. Ultimately he was to find in the work of Smith, Ferguson and Burke those ideas of spontaneous order, selective evolution, and unintended consequences (of human actions) which, in line with the inspiration he received from Mises, were to lie at the root of his rejection of the socialist and constructivist view of society.

It seems to have been this development in his outlook which caused a reappraisal on his part of the work of Menger. For his later references to Menger are overwhelmingly to the 1883 *Untersuchungen*. Indeed this is the single most important reference in Hayek's *Individualism and Economic Order* of 1949. Yet Hayek's early work, reprinted in 1984 as *Money, Capital & Fluctuations* (ed. Roy McCloughry), shows that while, at that date, Hayek was thoroughly immersed in the idea not merely of general equilibrium but of general equilibrium over time (this is particularly true of his 1928 essay 'Intertemporal Price Equilibrium and Movements in the Value of Money'), the evolutionism which was later to seem to him the most important legacy of Menger is absent while the subjectivism is very much to the forefront, and the problems of capital theory (which were ultimately fatal to Hayek's own programme in economics narrowly defined) are central.

During the time that he produced these early essays Hayek was already coming under the influence of Mises's work — the latter's *Gemeinwirtschaft* led directly to Hayek's abandonment of socialism — but Mises's work only took Hayek part of the way along the road towards his ultimate body of thought. For evolutionism is not a key matter in the work of Mises whose central interest lay in subjectivism, the problem of knowledge, and the co-ordination of individual decisions.

Some clue to the various strands in Hayek's initial intellectual background can be gained from his discussions of the important members of the Austrian School. It was the subjectivism, above all, which he stressed — it was, he claimed in the early 1940s, 'probably no exaggeration to say that every important advance in economic theory during the last hundred years was a further step in the consistent application of subjectivism' ('Scientism and the Study of Society', *Economica* (1942), p. 281). His main discussion of the work of Menger

is particularly interesting because it was published in 1934, as the introduction to an LSE reprint of Menger's works. It thus pre-dates his focus upon evolution and unintended consequences and was also written at a time when, particularly at LSE, it was possible to feel that Austrian economics was a, if not the, dominant force in the subject. In introducing Menger's 1871 *Grundsätze* he emphasised the standard Mengerian themes — needs, the means of satisfying them, and the distinction between goods of first and higher order. He also argued — and this is relevant to his 1928 paper cited earlier — that Menger had given a prominent role to time in his analysis. But above all he emphasised the steady accumulation of the subjective basis of the analysis, starting with goods markets and extending the ideas to factor markets, while all the time concentrating upon *individual* decisions, and justifying assumptions through introspection.

It is noteworthy in all this that Menger's 1883 book already referred to was lightly emphasised by Hayek at this time, and indeed in his subsequent discussions of Menger's work, even though it was to be of such critical importance for parts of Hayek's own work in the later development of the latter.

Despite the importance which he attached to the work of Menger, as the founder of the Austrian school, it was however Wieser whom Hayek credited with introducing the majority of the concepts which were later to prove important in the development of Austrian economics. From his treatment of marginal utility, and of imputation (factor rewards), it was Wieser who laid down the path of development followed by Austrian economics from the 1880s through to the 1920s. Indeed it is clear that in Hayek's initial training, before he came under the influence of Mises, the single most important element was the work of Wieser, supplemented by the work of Wieser's later disciples.

In discussing a member of the next generation of Austrians, Joseph Schumpeter, Hayek's attitude was, it must be said, a good deal less than reverential. Though Schumpeter provided him with letters of introduction for his visit to the United States in the early 1920s — resulting from a conscious effort by Hayek to broaden his intellectual training — the latter poked gentle fun, in his account of this, at Schumpeter's bombast and self-importance (*Collected Works*, vol. IV (1992), pp. 34–5). He wryly observed that bank managers' offices got larger the further east one went in Europe and that Schumpeter's office really belonged in Bucharest rather than in Vienna where the interview with Hayek took place. But he could write illuminatingly about Schumpeter

as an economist (*Collected Works*, vol. IV (1992), pp. 160–5) pointing out that the later enthusiast for macroeconomics and econometrics had originally been a strict methodological individualist but that he possessed an outstanding adaptability to intellectual fashions (*ibid.* p. 157).

With this intellectual background, and above all with the key Austrian emphasis upon subjectivism combined with the decisive influence of Mises, Hayek was able to build up his own research programme, a central part of which involved a sustained, courageous, and at times brilliant critique of many of the fashionable intellectual ideas of his lifetime. Subjectivism was linked not only with an interest in psychology (which resulted in *The Sensory Order. An Inquiry into the Foundations of Theoretical Psychology*, 1952) but also with the key Austrian emphasis on introspection. Like Cairnes, Hayek felt able to argue not only that introspection was fundamental in separating social science from natural science but also that it provided the economist with a kind of knowledge denied to the natural scientist. The difficulties with an emphasis upon introspection are too well known to need emphasis here; but it could be argued that a sufficient agreement by the relevant 'scientific community' on assumptions derived from introspection is a satisfactory starting point for the development of theorems deduced from those assumptions. But at all events this approach gave Hayek the basis for his critique of important (and at times extremely fashionable) elements in the intellectual history of our time. He attacked Historicism as the product of a fundamentally fallacious attempt to apply to history the methods (or what were believed to be the methods) of natural science. The attempts to formulate historical 'laws', attempts stretching from Comte to Marx, were completely misconceived and the outcomes bogus. The way in which society developed was the result of an uncountable number of individual decisions; we could understand those decisions through a theory developed on the basis of introspection but we could certainly *not* predict future social and historical development.

Historicism involved aggregating social phenomena in a meaningless way. It was, in turn, the basis for 'Constructivism', the idea that well-informed (and even possibly well-meaning) intellectuals could somehow plan and direct society. In 'Constructivism', an a priori belief in the virtues of planning led in turn to the idea that unplanned institutions could not be satisfactory and, by a *non sequitur*, to the idea that constructivist intellectuals could re-fashion institutions at will.

In attacking these ideas, Hayek produced distinguished work in



intellectual history. Particularly noteworthy were his two series, of three articles each, appearing in *Economica* in 1941 ('The Counter Revolution of Science') and in 1942–4 ('Scientism and the Study of Society'). In his critique, meticulously documented, of the work of Saint Simon and Comte, Hayek traced not only the intellectual pretensions of these progenitors of both socialism and totalitarianism but also the series of intellectual fallacies upon which their position was grounded. Of these the most important was the naïve belief — held particularly by dilettantes like Saint Simon — that the methods of natural science could be transferred to the much more complicated social and economic world. Following Mises, Hayek pointed out that social science had to cope with a world in which actions were based upon beliefs rather than upon objective facts, a world in which there could necessarily exist no detached body of fact on which the planner could operate, and a world in which order came about through the interaction between individuals, this interaction taking place by means of spontaneously evolved institutions — above all through markets. The attempt to import into the complex area of social and economic behaviour the attitudes and training of natural science led both to a primitive understanding of such complex matters as optimisation and to embarrassing naivety. Indeed Hayek seems to have taken a rather sardonic interest in the writings of scientists on matters of economics, up to and including Einstein, as well as in the writings of scientific popularisers. But he can hardly be blamed for failing to resist such a temptation when, as any reader of the correspondence columns in quality newspapers knows, natural scientists seem so anxious to give hostages to fortune.

The basis of Hayek's critique of 'scientism' in economics was fundamental. He remained completely unconvinced that the methods of natural science, whether in the form understood by Saint Simon and his followers, or in the similar form understood initially by Hayek himself, or, finally, in the form in which Sir Karl Popper persuaded Hayek that scientists really operated, viz. hypothesis formation and testing, could be transferred to social science. Indeed he remained sceptical about the whole matter of testing, since facts in economics were not physical. They were, rather, the beliefs of market participants. While he did, as in his article 'Economics and Knowledge' (*Economica*, 1937), mention both 'verification' and 'falsification', he was doing so in the context of the idea, stretching from Cairnes to Robbins, of

checking that the *assumptions* on which the theory was based were met, rather than referring to the testing of the *predictions* of a theory.

The extent of Hayek's opposition to 'scientism', set out in his 'Counter Revolution of Science' (*Economica*, 1941), is directly linked to his belief that the influence of the ideas of Saint Simon and his associates was far more widespread than had been appreciated (partly because many 'disciples' were reluctant to risk association with the ridicule attached to the name of Saint Simon) and that these ideas were linked directly and indirectly to the doctrines of both Hegel and Marx. Indeed Hayek was able to show that significant Marxist elements — notably the class struggle — originated with Saint Simon.

In all this work Hayek was concerned to provide a serious, sustained, and scholarly critique, motivated not merely by his distaste for the principal participants, and for their totalitarian descendants who by 1941 had engulfed almost the whole of Continental Europe, but by a very real concern at the damage which attachment to such erstwhile *chic* ideas — not least at LSE during Hayek's time there as indeed Popper has testified (*Cato Policy Report*, May/June 1993) — could do to the development of a free society and its associated market economy. The three main planks of Hayek's critique were as follows. Firstly, he rejected the idea that society could be profitably studied as a whole without reference to the individuals constituting it and to their individual actions. The paradox of self-proclaimed 'positivists' postulating such metaphysical entities as 'society', 'the economy', 'capitalism', and 'the class struggle' demonstrated the basic intellectual weakness of scientism in its emphasis upon 'wholeism'. Secondly, Hayek attacked Comte's idea that it was possible to construct some kind of 'social physics' and to find laws governing society which would be as definite as those of (genuine) physics. The laws of real physics required a clear concept of what constituted an 'observed fact' but such clarity in the matter of 'social physics' was conspicuously absent from the work of Comte.

The third plank in Hayek's critique was the observation that Comte and his latter day successors held, on the one hand, that the weakness of the human mind produced an unordered society while, on the other hand, they believed that the human mind was also capable of stretching to comprehend the problems of society as a whole and to plan that society.

Hayek was thus arguing, in his critique of scientism and constructivism, that a fundamental failure to understand the nature of human

society — and above all a fundamental failure to understand the nature of markets and thus of resource allocation — lay at the basis of socialism. It is not entirely clear whether both Mises and Hayek considered socialism to be impossible or merely impossibly inefficient. In the last resort the arguments put forward by Hayek certainly point in the direction of impossibility — at least in the long run — and he lived long enough to see the breakdown of the Eastern European regimes. The core problem which Hayek perceived was essentially that of knowledge. This initially involved a problem concerning goods markets; but the real problem lay in factor markets. It was this problem which showed that the idea of planning was fundamentally incoherent. For without a developed market system, in which unobservable preferences for factor uses could be registered through derived demand, there was no way that a planner could assign values to factor services. Thus 'cost' had no meaning outside a market system and a failure to recognise this was the central fallacy of the 'engineering of society' approach running from Saint Simon to Marx and Lenin (and their academic disciples). For without a competitive society there were no costs to be entered into calculations, and the parallel drawn by would-be planners between society and a single factory was shown to be fallacious.

Hayek did not stop at exposing the fallacies of totalitarian socialism; he must have derived a wry satisfaction from the failure of the 1960s fashion for 'indicative planning' since he had, in the 1930s, foreseen the difficulties with this as well, as is shown by a 1936 lecture, reprinted in *Money, Capital and Fluctuations* (1984, pp. 176–7). He returned to the issue in 1976 (*New Studies* (1978), pp. 232–46), weary that the new *chic* advocates of indicative planning had apparently learned so little.

Most of Hayek's work is patiently — even exhaustively — argued. His 1935 review of the socialist calculation debate (reprinted in *Individualism and Economic Order*, 1949) is fair and temperate. He was occasionally prepared to be both more direct and more actively interventionist. His *The Road to Serfdom* (1944) was such a strong statement of the dangers inherent, as he believed, in state intervention that even Lionel Robbins distanced himself somewhat from the ideas in the work (*Political Economy Past and Present* (1976), pp. 137–8). His foundation of the Mont Pélérin Society in 1947 (his opening address is reprinted in *Collected Works*, vol. IV) was an active personal initiative to bring together those who, in Sir Karl Popper's words, were 'scholars and practical economists who were opposed to the fashionable socialist

trend of the majority of intellectuals who believed in a socialist future.' (*Cato Policy Report*, May/June 1992.) Hayek served for more than twelve years as the President of this organisation. He ultimately left after a disagreement, the nature of which has not been made public. But the initiative was a powerful one in an international context. In a more purely British context, though it has spawned imitations, Hayek's role in the foundation of the Institute of Economic Affairs (*Collected Works*, vol. IV, pp. 192–3) was also an important and, in the long run, influential development.

Yet Hayek had to face the fact that, for long, academic conventional wisdom — and certainly the version of that wisdom conveyed to undergraduates — was that the contributions by Lange and Taylor had shown that socialism was, after all, plausible by employing Lausanne general equilibrium. As Hayek patiently pointed out, such writers had fundamentally failed to demonstrate *how* this could be done without markets (*Individualism and Economic Order* (1949), pp. 148–80). Moreover, even were it possible to accept the applicability of the Lausanne model to any real economic system, such a system would then be frozen at a particular stage of development and would be incapable of the economic evolution which was essential to progress.

Evolution — the evolution of economic and social institutions — was a central concern of Hayek and a core element of his later writings. There seems little doubt that he came to stress this idea as part of his critique of socialism. Evolved institutions, the product of the unintended consequences, through their interaction, of decentralised decisions, reflected social preferences in a way that a planned system, even were it possible to have such a system in a workable form, never could. But the argument, particularly in his later work, went much further than this. According to Hayek, evolved social forms embodied knowledge and transmitted socially beneficial values. A system evolved which compensated for the limited knowledge of each individual, and these individuals, acting with limited information, produced unintended consequences. These consequences were directed towards social good by the evolution of market institutions such as property and contracts, leading to the division of labour.

Hayek came ultimately to hold that the form of this evolution, and the role in it of unintended consequences, was the key question in economics from Hume and Smith onwards. But this evolutionary approach extended in his view beyond economic phenomena to religion and a moral code and indeed to the whole structure of civilisation

which depended on the human co-operation associated with the market. The forms thus evolved incorporated the lessons which society had learnt in discovering ways to reconcile different objectives.

Hayek thus looked at earlier writers with this particular question very much in mind. It was this idea which led him to regard Mandeville as a particularly important writer, one who had advanced a pioneering statement of the doctrine of unintended consequences through his thesis that what are private vices are often public benefits. Mandeville had also argued that it was the growth of law which ensured that this transition came about — the law developed to ensure this. Law was thus an evolutionary product, as were morality, language and money.

It is in this context that Hayek's stress upon law (as distinct from discretionary government) has to be viewed. The law, as Locke, Hume, Smith and Kant had all argued, safeguarded the individual against discretionary government while allowing society to develop. Hayek argued that the best form of this legal development was the Anglo-Saxon legal tradition, and he was a strong admirer of the great Common Lawyers such as Coke and Hale whom he believed to have made the world safe from Hobbesian 'totalitarian-positivist conceptions' (*New Studies* (1978), p. 158).

He drew a clear contrast between the British legal tradition, which he believed to have protected individual liberty, and the legal system ruling in Continental Europe. It was the British tradition of liberalism, as he saw it, which stressed the freedom of the individual under general law, that Hayek admired, contrasting it with the tradition of Continental liberalism which he believed to have become corrupted, particularly in France, by the ambitions of the would-be planners. Hayek was particularly sad to see that this Continental tradition had infected John Stuart Mill, an individual whom, without being blind to his personal weaknesses, he greatly admired and in the collection and publication of whose correspondence (notably that with Mrs Taylor) he had played a key role, demonstrating his usual impeccable scholarship.

This scholarship was also very much to the fore when Hayek, under the influence of Mises and his seminal work on money, *Theorie des Geldes und der Umlaufsmittel*, began to work on monetary economics. From the belated publication in his *Collected Works* of work written many years earlier, it is apparent that Hayek had a remarkable knowledge not merely of English but also of French and Italian monetary literature, as well, of course, of work published in German. He also did much to establish the importance of Richard Cantillon as a monet-

ary theorist and wrote illuminatingly about classical economics, perceiving the lack of originality in Ricardo's contributions to monetary debates while, as the editor of a particularly fine edition of Thornton's *Paper Credit*, he was a witness to the very best and most original of nineteenth-century monetary economics. But though Hayek's approach to this material was scholarly, the background to his interpretations was undoubtedly the monetary theory of Mises. He became a distinguished exponent of Misesian monetary theory in his own right and, together with Lionel Robbins, one of the two most important advocates of this neo-Wicksellian alternative to mainstream quantity theory and Keynesian analyses. Thus, in analysing the work of Cantillon, it was Cantillon's discussion of the effects of a change in *relative* prices which he stressed. He was also able to find much in the monetary theory of Thornton which could be related to the monetary theory which he and Mises put forward.

This monetary theory itself involved the idea that monetary expansion lowered the lending rate below the marginal rate of profit. This, an idea common to both Wicksell and Thornton, was the starting point. But for Mises, and for Hayek, the key element was not the fact that such monetary expansion raised the *general* price level; rather it was that monetary expansion altered the *relative* prices of consumption and investment goods. This in turn distorted factor markets. The expansion of the investment good market resulting from cheap credit captured resources from the consumption good market, and the leftward shift in the supply schedules for consumption goods raised their prices and imposed forced saving on consumers. However, the spending of the enhanced factor incomes, resulting from the bidding away of resources by the investment goods industries, restored the relative prices of consumer goods, and their outputs, through a rightward shift in the demand curves for consumer goods. A fresh bout of monetary expansion was thus necessary to enable the investment good industry to recapture resources to complete its projects. It is easy enough to see how this fits, as a disturbance, into a concept of general equilibrium in which, in equilibrium, the relative outputs of consumption goods and investment goods reflect consumer preferences for consumption goods and savings, the latter in turn reflecting social time preference.

It is also easy to see that a grounding in Böhm-Bawerk's capital theory could have led Hayek, in this context, to concern with the concept of the period of production, both because this bore a key relationship to social time preference and also because the length of the

production period determined the marginal profitability of investment. Such a concern was not strictly necessary. The Misesian monetary theory *can* be put forward without this 'period of production'. Robbins's own version did not employ it; and it is absent from quite a lot of Hayek's own macroeconomic writings. However, Hayek could not himself let go of the matter. Indeed, as will become clear, it was his unsuccessful grappling with capital theory which eventually brought an end to his purely economic writings, and which turned his interests towards the philosophy of the liberal market economic system.

We return to this issue below. It is however worth making the point at this stage that macroeconomic theory of this kind had important, and highly controversial, implications during a world depression. For in the early 1930s Hayek, together with Robbins and a few others, resolutely opposed suggestions for increases in government expenditure and the use of an expansionary monetary policy, both designed by their advocates to raise the level of employment. His position was clear enough. Monetary expansion was itself the source of the depression since, the Misesian analysis showed, it had distorted the relative prices of consumption goods and investment goods. The unemployment which existed was the result of difficulty in reabsorbing, into the consumer goods industries, labour which had initially been sucked from those industries into investment good industries and then released again as the initial promise of investment projects proved illusory. Further monetary expansion would simply delay the necessary readjustments in which a general equilibrium set of relative prices and interest rates was re-established, for it would enable investment projects which should never have been undertaken to be persevered with, as well as encouraging the undertaking of new sub-marginal projects. Public expenditure would not help either. It simply crowded out private expenditure and failed to produce a rise in aggregate demand — indeed all that resulted from it was a shortage of investment funds and even the failure to complete public investment projects.

Such a position was, hardly surprisingly, extremely controversial in the 1930s. It also seems to have involved, on the part of Hayek, Robbins and their allies, a fundamental error of fact: a failure to understand that the money supply of the United States had *fallen* sharply during the onset of the Depression. Evidence for such a misapprehension on Hayek's part is provided by a 1932 article by him (republished in *Money, Capital and Fluctuations* (1984), pp. 118–135,

especially p. 130). Robbins's *The Great Depression* (1934), also seems to have been written under the same misapprehension (*ibid.* pp. 73–5).

The Hayek-Robbins position naturally led to considerable difficulties in relations with Keynes. The relationship between Keynes and Hayek began badly in 1928 with 'strong disagreement' (*New Studies* (1978), p. 283); there followed an adverse review article by Hayek, considering Keynes's *Treatise*, which appeared in *Economica* in 1931. Part of his objection to this book can be traced to an aversion to the subjective originality of a work which was clearly Wicksellian, though with scant acknowledgement to Wicksell. A similar attitude can be discerned in Hayek's treatment of Keynes's *General Theory*, which he regarded as a 'tract for the times' (*New Studies* (1978), p. 284). At all events there is little doubt that during the 1930s Hayek, at least for a while, was Keynes's principal opponent. Hicks himself has recorded that:

it is hardly remembered that there was a time when the new theories of Hayek were the principal rival of the new theories of Keynes. Which was right, Keynes or Hayek? There are many still living teachers of economics, and practical economists, who have passed through a time when they had to make up their minds on that question; and there are many of them (including the present writer) who took quite a time to make up their minds. (*Critical Essays in Monetary Theory* (1967), p. 203.)

As a result of his difficulties with capital theory, Hayek withdrew from the controversy — though the primary reason which he gave for that withdrawal was that, having been assured by Keynes after the publication of the *Treatise* that he had already changed his mind, Hayek was reluctant to engage in a critique of the *General Theory* with the prospect of its author making the same response (*New Studies* (1978), p. 284). At all events Keynes and Hayek became, at least on the surface, reconciled during the Second World War and Hayek has paid tribute both to Keynes's astuteness and intellectual grasp and also to their personal *rapprochement*. But it seems reasonable to argue that this did not go very deep — perhaps on either side. On the one hand Hayek continued to hold that Keynes really knew no economics outside Cambridge economics, being particularly frank about this in an article written in 1966 for the *Oriental Economist*. He believed Keynes's knowledge both of trade and of capital theory to be seriously inadequate, and his lack of knowledge of German to be a significant handicap. He was opposed to Keynes's monetary nationalism and believed that the legacy of Keynesianism was inflation, although he seems disin-



clined to blame Keynes himself for this. On the Cambridge side there is no doubt that hard feelings remained; Lord Kahn, a leading member of the so-called 'Circus' was still retailing what he clearly regarded as his definitive put-down of Hayek, dating apparently from 1931, as late as his 1978 Mattioli lectures (*The Making of Keynes' General Theory* (1984), p. 182).

In the end, Keynes — or rather, perhaps, the Keynesians and Keynesianism — triumphed. But the real story of Hayek's withdrawal from macroeconomic controversy has to be seen within the context of his struggles with the theory of capital. He clearly believed that this was the key to a satisfactory macroeconomic theory — and also, to the defeat of Keynes. Indeed one of his charges against Keynes was a lack of a knowledge of capital theory. When he failed to develop a capital theory which met his aims he, in effect, gave up the struggle.

Hayek's clearest account of what happened, and of the circumstances which led to his virtual abandonment of the main battleground in economics, and the switch of his concentration to the wider issues of the operation and evolution of a decentralised economy, coupled with a retreat into guerilla warfare on matters of macroeconomics, was given in an article in the *Economist* (11 June 1983, pp. 45–8). From this, and other briefer accounts, it is clear that he had reached the conclusion that he had to defeat the central Keynesian contention that increased aggregate demand resulted in increased investment, output and employment. His effort to establish this came in two stages. The first was his 1939 *Profits, Interest and Investment* in which he used his celebrated 'Ricardo Effect' (which in truth does not derive from Ricardo) to explore the possibility that, with real wages in consumption goods industries falling in a boom, less capital intensive production processes might be substituted for more capital intensive production processes and that the net effect of this in the economy as a whole might actually be to lower overall investment. The next, and decisive, phase was the publication of his *Pure Theory of Capital* in 1941. This was the fruit of a sustained effort to develop Austrian capital theory to the point where it could be used as the basis for a decisive critique of the Keynesian multiplier. The book itself represented the first half of the enterprise; the second half of the enterprise was to be an application of the pure theory of capital to a critique of Keynesianism. But Hayek was intellectually exhausted at that point; and he also, he later wrote, was anxious not to undermine Keynes's position as a wartime adviser and, in particular, Keynes's opposition to wartime inflation.

Whether this is the whole story seems doubtful. While Hayek did not abandon his intellectual position on capital theory — indeed it is lucidly stated in the *Economist* article, and applied to Keynesianism — it seems reasonable to conclude both that he was too exhausted intellectually to work out fully the theoretical critique and to link it to the capital theory and — perhaps most importantly of all — that he had decided that aggregate demand management of a Keynesian variety constituted a much smaller threat to a free society than socialism and scientism in all their various forms. It was thus the latter on which he concentrated his efforts from 1940 onwards.

But the desire to find a theoretical basis for a fundamental critique of aggregate demand management — and for a revival of John Stuart Mill's dictum that 'Demand for Commodities is not Demand for Labour' — explains Hayek's constant return to the difficult matter of an average period of production for the economy. For the period of production in itself is *not* essential to the Mises-Hayek monetary theory of the cycle. The key factor in that is, as already noted, the proposition that the flows of consumption and investment goods should reflect the preferences of consumers as a whole for production today and production in the future. Early papers, reprinted in the 1984 volume on *Money, Capital and Fluctuations*, notably those on intertemporal equilibrium, on United States monetary policy, and on the theory of interest, do not in fact rely on the period of production concept. Moreover other 'Austrians' — Machlup and Robbins (the latter in his *The Great Depression* of 1934) — were able to explain the Mises-Hayek theory without reference to the period of production. Hayek's own *Monetary Theory and the Trade Cycle* itself does not rely on this concept. But the key point seems to have been that Hayek felt that he had to use the period of production not because it was central to his *own* macroeconomic model but because he believed that it was the only way to defeat the aggregate demand model of Keynes. He failed.

In a sense the whole exercise was futile. Not only is it arguable — and has been argued, as Mark Blaug shows in his brilliant survey in *Economic Theory in Retrospect* — that the whole Austrian theory of capital, and its central concept of the period of production, was so deeply flawed that the outcome could only be the dead end in which Hayek found himself; it is also true that the whole theoretical structure could be explained merely by reference to the marginal productivity of new investment without getting entangled in Austrian capital theory. It is perhaps a measure of the intellectual honesty of Hayek, however,

that he was not prepared to leave the matter there but sought directly to confront the Keynesian contention that increased aggregate demand increased employment, braving the (ultimately fatal) quicksands of that capital theory.

Whether this was a sensible approach, methodologically speaking, is even more open to question. For one theoretical apparatus cannot invalidate, on a priori grounds, another theoretical apparatus. They should be tested by reference to the available data. Such a test would undoubtedly have supported the Keynesian position rather more strongly than the Hayek-Mises one, though Robbins's gallant effort in *The Great Depression* to deploy the data to establish the opposite should not be overlooked. But at all events such a confrontation of theory with data was anathema to Hayek the a priorist.

But all this, though it goes a long way to explain Hayek's eclipse as a mainstream economist, should not blind us to his stature or his achievements. Mark Blaug has called him 'Böhm-Bawerk's last and greatest pupil' (*Economic Theory in Retrospect*, p. 571). But he was much much more than this. He was Mises's greatest pupil, the great voice of sanity countering the vain wishes of academics to plan society, the great inheritor and expositor of the Austrian understanding of the fundamental nature of markets, and perhaps the last great scholar-economist, roaming over the literature of centuries in an intimidating range of languages and patiently distilling his message of hope in an evolving free society under the rule of general law.

In considering Hayek's life there is, it is true, some sense of sadness at the intellectual isolation which he endured. On the one hand it is true that, in 1974, the Nobel Committee awarded him, jointly with Myrdal (in what many at the time saw as an ingenious balancing act), the Nobel Memorial Prize in Economics. The Committee indeed revealed that the names of both candidates had been amongst those proposed since the inception of the Prize. With considerable dexterity the Committee managed to pay tribute to *both* Myrdal and Hayek for their blending of political and economic considerations, while praising Hayek's individual achievements both in macroeconomics and in his critique of central planning. But even here there is some unease; for Hayek, it appears, did not believe that there should be a Nobel Prize for economists. Nonetheless, here was recognition. Again, it is true, that a limited number of writers of a different — and in one case, that of Lord Desai, it would perhaps be fair to say a *very* different — stamp to Hayek were prepared to treat his ideas — notably on the economics

of information — seriously and with respect. These writers included R. C. O. Matthews (*Manchester School*, 1981), and Lord Plant (in Birner and van Zijp, *Hayek, Co-ordination and Evolution*, 1994).

But the broad picture is much more depressing. Hostility in Cambridge was perhaps to be expected — Kahn's jibe noted above pales into insignificance when compared with Joan Robinson's reminiscence of the same lecture, a reminiscence also dating from nearly half a century later (cited in Hayek's *Collected Works*, vol. 9, ed. Bruce Caldwell, p. 25). But the hostility went wider than the Marxist left as epitomised by the following reminiscence:

One of us vividly remembers the difficulties he had when submitting a proposal for an MA thesis on Hayek's economics in the Netherlands at the end of the 1970s. It took quite some effort and persistence to get the subject accepted — grudgingly, because the only thing academics 'knew' about Hayek was that he was a reactionary (Birner and van Zijp, p. x).

As Jack Birner has noted, 'Until recently, F. A. Hayek was very much an intellectual outcast.' (Ibid. p. 1.) Birner has explained the situation very well:

To this very day, Hayek's economics is almost completely unknown to his fellow-economists, and Hayek the economist remains a lone-ranger. His social philosophy has fared only slightly better. Thus, most of Hayek's career is surrounded by a sense of tragedy. Personal tragedy in that he rarely found the recognition he deserves given the astounding width and depth of his thought which was so often so far ahead of developments in areas which he sometimes entered as a self-professed amateur. There was tragedy, too, for those fields of intellectual endeavour that, usually out of ignorance, failed to use Hayek's insights to their advantage. (Ibid. p. 2.)

This theme could be illustrated at length. While Hayek received, particularly in *Politics and Economics* (1963) some limited recognition by Lionel Robbins, his one-time close associate, it is quite extraordinary to record that a great figure like Michael Oakeshott, with very much in common intellectually with Hayek, should so far have failed to appreciate Hayek's emphasis on evolutionism and unintended consequences, and his opposition — which went even further than Oakeshott's — to a constructivist approach to political problems, that he could dismiss Hayek as a rationalist (*Rationalism in Politics* (1962), p. 21). (Hayek for his part also failed to recognise a natural intellectual ally — his *Law, Legislation and Liberty* (1973–9) refers to Oakeshott only twice, both of them distantly.) This epitomises Hayek's isolation. Why and how it occurred is a considerable puzzle, though some may feel

that it is one that does not reflect well on the academic profession, particularly in contrast with the deference accorded to the apologists for totalitarian regimes.

Yet somehow Hayek rose above the neglect of his work even by those who were his natural allies in the intellectual arguments against socialism, constructivism, and totalitarianism. The valuable pluralism of American academic life — in his case, in Chicago — came to his aid, as it did to that of Mises. By patiently developing, refining, and expanding his exposition he ultimately succeeded — aided by that very evolutionary march of human affairs on which he laid so much stress — in bringing to the attention not merely of economists but of political writers and constitutional theorists the fundamental issues to which he had devoted his life's work.

DENIS O'BRIEN  
*Fellow of the Academy*

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