

Hayek versus Keynes: How a free-market economist defeated the 20th century's most famous proponent of central planning

by [Brian Lee Crowley](#)

This May marks the centenary of the birth of Friedrich August Hayek, the Nobel Prize-winning economist, who led the intellectual battle against the central planning ideas of John Maynard Keynes.

Unlike a clash of armies, in the battle of ideas, clear-cut victors seldom emerge. In Hayek's case, however, it is clear that his ideas changed the course of postwar history, changed it palpably and demonstrably in the direction of greater individual liberty and personal responsibility. And, remarkably, he performed this prodigious intellectual feat not just once, or twice, but three times.

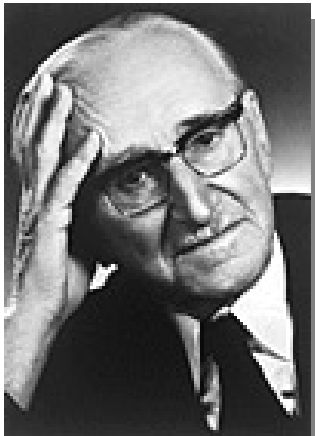
The first was at the defeat of the Axis powers, when he captured American public opinion with a powerful critique of government economic planning in peacetime. The second was when Margaret Thatcher and the British Conservatives used his tool kit of ideas to understand and then reverse the consequences of decades of creeping state domination of British society and the economy. And, finally, at the fall of the Berlin Wall, many intellectuals in Eastern Europe turned to Hayek's work to understand how to foster the institutions of liberal freedom in a soil made stony by decades of Marxism-Leninism.

F.A. Hayek began his academic career in the 1920s at the Austrian Institute of Economic Research, but within a few years he left the ruins of Austria for the London School of Economics. Lionel Robbins, the head of the economics department at the LSE, was disturbed by the turn British economics was taking, a turn inspired by Cambridge's emerging economic guru, John Maynard Keynes. Robbins sought a powerful new exponent of the virtues of markets, competition, and non-intervention, and when Hayek came to deliver a lecture at the school in 1929, Robbins knew he had found his man. By 1931, Hayek had been appointed to a named chair in economics at the LSE and was arguably the most influential young economist of his generation.

Thus began a curious and complex relationship between Hayek and Keynes. Punctilious professional colleagues and scholarly rivals, they wrestled for years over the appropriate role of government in the economy and the impress that economics should leave on public policy.

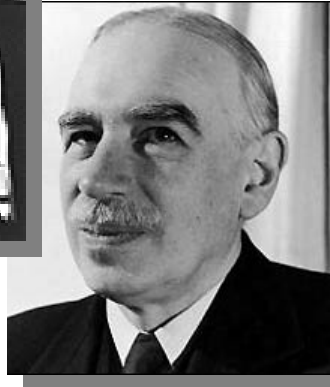
For all the correctness that characterized their relations - Hayek was, for example, Keynes' guest when the LSE fled the Nazi bombings to the relative safety of Cambridge

- the Austrian could not shake a profound distrust of Keynes. A brilliant economist, captivating teacher, witty conversationalist, and bon vivant, Keynes seemed to almost everyone who knew him a Renaissance man and one of his country's most powerful minds.



F.A. Hayek (above) was appalled at John Maynard Keynes' (right) superficial analysis of issues and was often critical of his theories.

To Hayek's eyes, however, he appeared rather differently - as a man who always had a glib and superficially convincing scheme to solve every problem but who cared little for his schemes' long-term consequences. After all, it was Keynes who remarked that, in the long run, we are all dead.



Keynes' intellectual dilettantism appalled Hayek. When Keynes wrote *A Treatise on Money* in 1930, Hayek spent a full year carefully analyzing it, and then wrote a devastating review. At their next meeting, Hayek was outraged when Keynes airily said that he agreed with Hayek, but it was all beside the point because he had long since changed his mind in any case. Hayek always regretted that this incident led him to neglect replying to

Keynes' next book, because it swept all before it, and by the time Hayek was alive to the danger, it was too late.

Keynes' 1936 *General Theory of Employment, Interest and Money* became the bible of a whole new generation of economists, first in the universities, and later in governments around the world. The Keynesians, as they came to be known, shared Keynes' own unshakable belief in the ability of clever people, like himself, to smooth out capitalism's cycles of boom and bust by manipulating the level of demand in a nation's economy, through, for example, inflationary monetary expansion and large public works programs. Such vigorous actions appealed to a world already in the grips of a devastating depression - far more than the "do-nothing" non-interventionist economics of the likes of Robbins and Hayek, who counselled letting the economy's self-corrective mechanisms do their work. To those concerned about the inflationary consequences of his policies, Keynes breezily asserted that inflation was the hallmark of rising civilizations.

In the very early days of Keynes' apotheosis, Hayek was already explaining why this clever scheme too would come to grief. He showed how the consistent pursuit of Keynesian policies would, in the long run, produce simultaneous inflation and economic stagnation and unemployment. The long run was reached in the 1970s, when economists had to coin a new word, stagflation, to describe a condition Keynesians had always dismissed as impossible. Far from being a "general theory," Hayek saw Keynes' book as nothing but a superficial tract for the times.

But in the Dirty Thirties, the long run seemed very abstract and far away. Mass unemployment and industrial paralysis were again causing the collapse of people's hopes and expectations. Dire circumstances were calling forth fearsome responses, as continental European nations succumbed, one after the other, to totalitarian solutions, often to the applause of intellectuals in the English-speaking world. In the United States,

Roosevelt's New Deal brought in its train a far more activist government than the republic had ever known.

These were not Keynesian policies, however. Keynes' ideas were only just beginning to filter out of the universities and had not yet won the allegiance of policymakers. One more push of history was needed to create the ideal conditions for the comforting illusion of a costless form of rational economic management that would banish forever the inexplicable vagaries of markets and laissez-faire. That push came on Sept. 3, 1939, when war broke out between Britain and Germany.

When backed by a large social consensus, war brings a unity of purpose in which most people willingly submerge a great deal of their personal liberty. The Second World War carried this willing renunciation of freedom to new heights. The Allies were locked in a struggle with powerful totalitarian societies that could direct every citizen's energy to the war effort. Britain, Canada, the United States, and others could afford to do no less. Not only were soldiers conscripted, but so too was labour. Bureaucrats, not markets, distributed raw materials; the needs of the war effort, not of consumers, determined what to produce and in what quantities. Wages were controlled, as were prices and profits. Strikes were not tolerated. Essential foodstuffs were rationed. The media willingly connived with government officials in spreading propaganda about the war effort in order to keep morale high. No sacrifice was too great.

Moreover, the Allies counted among their number the Soviet Union, a society used to this kind of control. The Eastern Front was vital to the success of the war effort, and the heroism, struggle, and sacrifice of the Soviet troops and people were constantly praised by the propaganda machine, while the fundamental differences between the two types of societies were a forbidden topic.

People marvelled at the effectiveness of the war effort. Unemployment was replaced by efforts to find enough workers, inflation was outlawed by decree, and ultimately, the sacrifices brought their due reward: The Axis powers went down to defeat.

The people who ran the war effort noticed the success of these highly regimented efforts. They began to ask themselves why clever people like themselves couldn't simply go on running the economy, and along the way restructure society to eliminate the prewar scourges of poverty, hunger, and unemployment. Long before the war's end, plans were afoot to trade on the prestige of the successful war effort, and the solidarity it had created, to transform wartime planning into peacetime social engineering.

In Britain, the government-commissioned Beveridge Report, which proposed a vast expansion of the country's still-embryonic welfare state, epitomized the new thinking. The Labour Party won its first ever parliamentary majority in the 1945 election on a slogan suggesting the application of wartime solutions to social problems: "And now, win the peace." In the United States, the New Dealers, bolstered by both victory in war and Keynesianism's intellectual respectability, were determined to press interventionism. More ominously, those far cruder thinkers who rejected outright any role for capitalism and markets were ascendant in Eastern Europe, often with popular support, as in Czechoslovakia and Yugoslavia. There, planning was to be total and totalitarian, necessitating the emergence of an iron curtain to separate the two forms of society.

Intellectuals were under a dangerous self-delusion that mastery of our social and economic life lay in their grasp. Deeply troubled by what he saw, Hayek set out to expose the rational-sounding claims of the salivating planners for what they were, the oldest scam in marketing: bait and switch. Planners promised a world in which the public's needs and desires would be satisfied more efficiently and with less waste and human misery than ever before. The reality, Hayek knew, would be that people's lives would be planned to satisfy the needs and desires of the planners, and that ultimately, if left unchecked, the economic waste and loss of individual freedom would be devastating.

This was Hayek's central argument in his 1944 classic, *The Road to Serfdom*, his one and only foray into a popular, polemical format to make his ideas known. The impact, on both his professional life and public opinion, seems almost unimaginable today, when these ideas have become part of the mainstream.

At a blow, Hayek alienated the intellectual community of which he had been such a paragon. As if he had uttered some unforgivable social solecism, he was banished from the polite company of the bright young things so convinced that their brains, good intentions, and selfless devotion to the public good would usher in an unprecedented era of human flowering. Virtually alone among British left-wing intellectuals, George Orwell found much he agreed with in the book, but then, he had seen with his own eyes in the Spanish Civil War the European left's dangerous flirtation with totalitarianism.

The book sold well enough in Britain. When it reached the U.S., however, *The Road to Serfdom* became a publishing phenomenon. It rapidly went through several printings and was abridged in a hugely successful edition by Reader's Digest. *Look* magazine published a cartoon version. Business and press opinion was strongly favourable. Hayek went on a lecture tour and was lionized except, again, in intellectual and university settings, where he was excoriated.

Keynes liked the book, although its full import escaped him. He told Hayek that, while the dangers that he saw were well founded, as long as intelligent and well-meaning people like themselves were in charge, they could easily prevent things getting out of hand. Of course, part of Hayek's argument was precisely that even good people would be corrupted or forced aside by the coercion that is necessary to give central planning even a semblance of success. Shortly afterward, Keynes died, and no one had the stature to put the brakes on the planning juggernaut, now directed largely by Keynes' disciples. A few years later, virtually every European country had a ministry of planning, and a British Tory prime minister could proclaim, without fear of contradiction, that "We're all Keynesians now." Perhaps no other explanation is needed of *The Road to Serfdom*'s dedication: "To the socialists of all parties."

But in the long run, fittingly, Hayek's ideas were to prove so powerful that even his colleagues would return him to professional respectability, which finally came with a Nobel Prize in 1974, 30 years after *The Road to Serfdom* first appeared.

Brian Lee Crowley, is the president of the Atlantic Institute for Market Studies. This article is excerpted from the spring issue of The Next City.