

Europe and China: the Fatal Conceit

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Of all the great insights that Friedrich August von Hayek bequeathed to us in his work, one in particular shines out today.

For its truth has never been more evident, its application never more universal.

And it is one that the Institute of Economic Affairs has done most to educate politicians and opinion formers about.

It is that running through the ideological and political divisions of human history are two distinct and different ways of looking at the world.

Between them is a deep and irreconcilable divide.

One Hayek called constructivist rationalism. The other he called evolutionary rationalism.

Not phrases to trip off the tongue, to be sure.

JK Galbraith was always the better wordsmith - if not the better economist.

Hayek spent a lifetime arguing that constructivist rationalism is economically and philosophically flawed because it assumes that

“all social institutions are, or ought to be, the product of deliberate design”.¹

Hayek later famously called this the Fatal Conceit².

Those who follow this route believe they have it within their power to build, organise and mould society so that it conforms to their concept of what is just and efficient.

But it leads, he argued, to economic decline, poverty, social regression and, in extremis, famine, starvation and the collapse of civilization.

Historic examples of this mindset, said Hayek, included Sparta, the French Revolution, Communism in general and the Soviet Union in particular, Fascism, Nazi Germany – indeed all the tyrannies that blighted the 20th century. As Hayek famously put it, it is the Road to Serfdom.³

Hayek favoured “evolutionary rationalism”.

It understands that there “exists orderly structures which are the product of the actions

¹ F.A. Hayek, *Law, Legislation and Liberty: liberal principles of justice and political economy*, Routledge, 1982, p5

² F.A. Hayek, *The Fatal Conceit: the Errors of Socialism*, University of Chicago Press, 1988

³ F.A. Hayek, *The Road to Serfdom*, Routledge, 1945

of many men [and women] but are *not* the result of human design”.

Hayek believed this the right approach because it is compatible with the teachings of economic science and goes with the grain of human nature; for these reasons, he thought, it leads to prosperity, progress and the flourishing of humanity.

Evolutionary rationalists such as Hayek argued that the liberal market economy, for all its apparent duplication, unfairness, inequalities and instability leads to wealthier, freer *and* fairer societies than all the great plans of constructivist rationalism.

Indeed, he argued, it was the only way to run and sustain a successful advanced economy, a matter of some relevance, we shall see, as Europe struggles to cope with the rise of Asia.

Though Hayek clearly preferred evolution and the market to revolution and central planning, he was not a small-c conservative, as he made clear in the postscript to *The Constitution of Liberty*.⁴ Rather, Hayek was a liberal in the classical, British sense of that word. He took to calling himself an “Old Whig”, a term which

⁴ Why I am not a conservative, *The Constitution of Liberty*, The University of Chicago Press, 1960

understandably his followers are not overly keen to use today.

But Hayek had no truck with those who sought to preserve the status quo, existing hierarchies or to block change.

He supported the market for the very reason that it is disruptive; he relished Schumpeter's "creative destruction". Progress occurred when an unpredictable market was allowed to proceed unimpeded; progress was halted when politicians and planners pretended to know the future and to mould society and the economy accordingly.

Hayek's work is part of a long and illustrious tradition which includes the great philosophers of the 18th century Scottish Enlightenment – David Hume, Adam Smith and Adam Ferguson. His great achievement was to adapt this tradition to the circumstances of the late 20th century and beyond.

An early and influential proponent of the alternative, constructivist view was Rene Descartes, the 17th century French philosopher, who famously claimed to have proved that he existed by virtue of being a sentient being.

The problem with the Cartesian view when applied to political organization and economics, said to Hayek, is that it gives the green light to unlimited, hubristic social engineering.

Hayek thought that Cartesians ignored the great insight of the Austrian school of economics, whose leading lights included Carl Menger and Ludwig von Mises, as well as Hayek: that much information is simply not knowable in advance and can only emerge through an evolutionary and competitive market process.

It was the great Norman Macrae, deputy editor of *The Economist* during the decade I spent there, who once explained to me that if, 20 or 30 years ago, politicians, pundits, academics, experts and bureaucrats had been asked what sort of jobs would fill *today's* newspaper recruitment pages, they would all have been hopelessly wrong.

Why? Because we have no accurate idea of what technological innovations will emerge over the next two to three decades or their implications for society and economy – and therefore for employment.

Nobody accurately predicted, for example, the rise of the internet 20 years ago, which only underlines the futility of trying to pick winners.

It is a lesson many politicians seem determined not to learn. But the market is too unpredictable to be double-guessed, as the French learnt at great cost with their ill-fated Minitel, which merely delayed the adoption of the internet in France.

The market, Hayek taught us, is a “process of discovery”; it does not exist simply to allocate existing resources, though it is the most efficient mechanism for doing so.

The “right” price for a product doesn’t exist in any objective way, argued Hayek. Prices emerge from supply and demand, reflecting a myriad of ever-changing variables that can never be known to a central planner.

Only a decentralised society with property rights, the rule of law and a competitive market economy can compute this information. The market, said Hayek, is the only institution capable of co-ordinating the actions of millions of human beings in a way which leads to progress and prosperity, rather than chaos or stagnation.

Supporters of Hayek are indebted to him because he made it plain that planning and economic controls cannot hope to outsmart the combined wisdom of the market - whether grocery market or stock market - and the myriad of free, voluntary decisions that it daily represents - the democratic vote of millions of wallets.

It has become fashionable to argue that the past 20 years have seen something of a political consensus congeal around the Hayekian worldview. But Hayek would not recognize his apparent triumph.

The intellectual battle between collectivist central direction and the decentralized market economy has not ended with the collapse of the Soviet Union.

Today, of course, everybody -- apart from the new Marxists of the radical environmental and anti-globalization movements -- broadly accepts that societies should be largely market economies.

But if Hayek were alive today, he would be deeply concerned at the way the major European economies, including Great Britain, have succumbed to the allure of constructivist

rationalism, with its concomitant inexorable rise in the size and power of the state.

Hayek took much comfort from the manner in which Europe emerged from the ruins of the Second World War as an economic powerhouse, thanks partly to the radical liberalisation of post-Nazi Germany by Ludwig Erhard, a disciple of Hayek.

But he would be dismayed how Europe, over the last few decades, has turned its back on many of his principles – and paid the inevitable price in terms of lower growth, fewer jobs and less wealth creation.

Hayek would consider today's levels of European public spending, tax, red tape and state intervention to be in the red zone that is dangerous to your economic health.

They have certainly moved decisively higher than those of the United States and other market-based economies around the world.

According to the latest projections from the OECD, governments in the euro zone will spend just short of 50% of their gross domestic (GDP) this year, against 36% in the

America and Australia and only 28% in South Korea.⁵

The rise in the size and scope of government, Hayek would argue, is a major reason why Europe finds it so hard to compete – and even inhibits attempts at reform.

The much-vaunted and British-inspired Lisbon Agenda of 2000 – with its goal to make Europe “the most dynamic and competitive knowledge-based economy in the world” by 2010 – is already an irrelevant joke.

The rise of the European Union, on which so many of us pinned our hopes for so long, was rumbled as a grandiose project by Hayek long before Euroscepticism became fashionable.

To a Hayekian, there are few starker instances of his Fatal Conceit than the EU’s hubristic launch of a single currency.

The Euro’s supporters, of course, were hardcore Cartesians. They devised what they thought was a purely rational currency, abstracted from history, experience, culture or even economics.

⁵ OECD Economic Outlook 77, June 2005

Their aim was to get rid of the messy, seemingly irrational patchwork of different currencies across Europe, all irritatingly lacking uniformity and harmony.

To them, it was self-evident that Europe ought to be a single country; and that countries should have their own currencies. Any economic objections to the single currency, and there were many, were dismissed as irrelevant.

The argument always was that if there were enough political will and clever administrators to push it through, the project would triumph.

Today Hayek would be telling us that the Cartesian result was wholly predictable: the creation of an inappropriate, one-size-fits-all monetary policy in an area which is far removed from what economists call an optimal currency area.

It is now widely accepted among economists that the single currency has helped keep Germany and Italy in recession or near-recession while fuelling an inflationary boom at the periphery of the Euro zone, in Spain and Greece.

Hayek would not have been surprised: it is the stiff price you pay for abandoning evolutionary rationalism.

Yet, as Europe finds itself in a Cartesian bind which is dragging it down, things are stirring on the other side of the world, where Hayek's principles have found new and powerful disciples.

China has been gradually moving in a more Hayekian direction over the past two decades, after learning at incalculable cost in human lives and resources, that communism does not work.

By unleashing its people and adopting at least some market-based institutions, the Chinese government – for all its continued attachment to totalitarianism, a truly horrible human rights record and worrying military ambitions – has bowed to reality in one crucial respect.

It has ditched its rigid adherence to constructivist rationalism.

It has accepted the main insight of Hayek's evolutionary rationalism.

That the only way to unleash the potential of human beings is for the government to focus

on defending and enforcing the key institutions of the market economy, allowing what Hayek called a spontaneous order to flourish.

Beijing, of course, still controls its people, prevent them from reading or watching or thinking what they like, all of which Hayek would have abhorred.

But it no longer tries to direct or organize all economic activity, as it did during the terrible days of Mao, when tens of millions died. Hayek would have seen this trend as a necessary if still far from sufficient step on the road *back* from serfdom.

The result of China's slow and incomplete embrace of the market has nevertheless been the greatest and fastest explosion in economic growth, creativity and human ingenuity in the history of the world.

China has a long way to go to meet Hayek's demanding criteria for a free and prosperous society.

As we have seen in recent days, this is still a country whose leaders cannot even bring themselves to tell their own people about a massive environmental disaster.

Huge economic distortions remain, including a deeply defective banking system plagued with bad debts. Inflation is too high, corruption endemic.

There can be no proper market economy or individual freedom in the absence of the rule of law and entrenched property rights, two democratic necessities that dictatorships always deny, China's included.

But at least China is moving in the right direction, which cannot yet be said of Europe.

And with each step away from Communist Constructivism to Hayekian capitalism, China has been richly rewarded. It is now the world's number one producer of LCD screens and TVs⁶; it makes 90% of the world's toys, 70% of its photocopiers, 50% of its cameras, 40% of its microwaves, 30% of its handbags and suitcases and 16% of its clothing.

The pace of growth has defied all predictions: in 2004, the World Energy Council forecast that China would consume 1.3bn tonnes of oil equivalent by 2010; it managed that before

⁶ Ted Plafker, "For direct investors in China, daunting risks" International Herald Tribune 14 Nov 2005

2004 was out⁷ and now stands as the world's No 2 consumer of energy after the United States⁸, hence the current upward pressure on world energy prices.

China's rise has been astonishing. But it has only just begun.

China has yet to become a proper market economy and what capitalist institutions it enjoys are still largely confined to the booming South.

China should really be viewed as an amalgam of five zones⁹, only three of which are booming: the Pearl River Delta which borders Hong Kong, the Yangtze River Delta near Shanghai and the Bohai Rim.

Think what will happen to the global economy and the geopolitical balance of power if all of China continues to move closer to a Hayekian view of the world, with a growing middle class and all the trappings of wealth, science and technology.

⁷ SEI Investments, "China's Impact on oil in the global market" November 2005

⁸ BP Amoco Statistical Review 2005 shows China consuming 13% of the world's energy supply in 2004. USA came first with 26% and Russian Federation third with 6.5%. The EU25, as a block, consumed 16.8%.

⁹ Speech by Gerard Lyons, chief economist at Standard Chartered, to the EU-China Business Summit in the Great Hall of the People in Beijing on 5 Sep 2005.

Then think back to Old Europe, with its endless navel-gazing of the irrelevant, tedious obsessions with farm subsidies and 35-hour weeks, bloated welfare states which sap the incentive work and a bureaucratic desire to regulate all that moves -- and much that doesn't.

Even just the partial embrace of Hayek has allowed China to enjoy the fastest pace of poverty reduction in its long history – perhaps in the history of the world – without any help from well-meaning Western politicians and their talk of Marshall Plans for the poor, another contemporary Fatal Conceit.

Numbers in absolute poverty, defined by those living on less than \$1 a day, have collapsed from 64% to 17% of the Chinese population¹⁰. With annual growth averaging 8% for the next 20 years¹¹ -- far from an impossible rate – China will be ranked among the world's richer middle-income countries within the next decade.

¹⁰ Robert Skidelsky, The Chinese Shadow, New York Review of Books 17 November 2005. Full article available online at www.nybooks.com/articles/18437#fn2

¹¹ Press release on http://news.xinhuanet.com/english/2005-11/17/content_3796739.htm

Economists tell us that, in dollar terms, the Chinese economy will overtake Germany by 2009, Japan by 2015 and the US by 2039. India's economy, in the grip of its own Hayekian reforms, could be larger than all but the US and China within 30 years.

Now I have no idea if these long-term predictions will come true in that timescale: trees do not grow to the sky, political turmoil could easily delay or even derail the Chinese economic miracle.

Most economists cannot yet agree on what last year's growth rate was, never mind the one in 2039. As a colleague once said, economists only use decimal points in their forecasts to show they have a sense of humour.

But whatever the scale and pace of growth in China, India and other economies embracing market-led reform and growth, one thing is pretty clear: of the current G6 (America, Japan, Germany, France, Italy, Great Britain) only the US and Japan are likely to be among the six largest economies in US dollar terms by the middle of this century.¹²

¹² Dominic Wilson and Roopa Purushothaman, Global Economic Paper 99, Dreaming with Brics: The Path to 2050, Goldman Sachs, 2003

So: not a single European economy will be in the top six. This is a seismic change in the global economic balance of power and however you look at it, Europe is the loser.

It is not just a matter of economics. Europe's demographics also point to its continuing demise as a global economic player. From 2010, Europe's indigenous population will start to decline as deaths outnumber births; it is only through immigration¹³ that its population will continue to grow.

But the headline figures conceal a collapse in the working-age population, which will fall from 67% today to 57% in 2020. By then, one in 10 Europeans will be an octogenarian – today, only 4%. Our continent is becoming the retirement home of the world.

With fewer workers, and a soaring number of pensioners to sustain, and hence a looming pensions crisis, Europe is on an inexorable slide which its recent enlargement cannot reverse; indeed the 10 new member states

¹³ Eurostat, 8 April 2005 STAT/05/48. Full details can be read on <http://europa.eu.int/rapid/pressReleasesAction.do?reference=STAT/05/48&format=HTML&aged=0&language=EN&guiLanguage=en>

suffer from even worse demographics¹⁴ than the original 15.

The contrast between Europe and China is most dramatic in cross border capital flows – especially foreign direct investment flows (FDI).

We are in the midst of a massive gravitational pull of plant and capital away from Europe's high-cost economies. It is starkly evident in the latest figures on FDI posted by the OECD this year.¹⁵

These flows are re-writing the economic map of the world, changing the balance of economic, political, military and cultural power.

They are a Hayekian revelation in action: the huge collective vote of thousands of companies round the world, the one collective vote that really counts in economics, the voting of corporate wallets, stampeding to Asia.

¹⁴ David Willetts addresses this in "Old Europe? Demographic change and pension reform" published by the Centre for Economic Reform September 2003. Available to buy online at www.cer.org

¹⁵ *Trends and Recent Developments in Foreign Direct Investment*, prepared by Hans

Christiansen and Ayse Bertrand of the OECD's Investment Division. OECD International Investment Perspectives, June 2005 edition.

Also Recent, *Trends in Foreign Direct Investment in OECD Countries*, Updated note, September 22 2005,) OECD.

Consider the following:

In France, the *outflow* of direct investment abroad shot up from \$16bn in 1994 to almost \$50bn last year.

In Italy it has gone up from \$5bn in 1994 to \$19bn last year.

Inward FDI to Germany and France fell sharply last year.

In France the inflows almost halved. In the case of Germany the figures look to have dropped off the bottom of the scale: foreign investors withdrew about \$39bn from the country last year, not what you'd call a vote of confidence for the new government in Berlin.

No prizes for guessing who the main recipients are. Inward FDI into Mainland China keeps hitting new records. It reached \$55bn last year, the highest level on record and well above what even Japan enjoyed in its heyday.

Pause here to note the differential impact of the rise of China on Europe and the United States. The sucking sound of capital being pulled out of Europe and into East Asia is

almost deafening. But the OECD is still able to say that, as a direct investment destination, “the United States is ... in a class of its own”.

Of course, its leading companies are, like their European counterparts, are also investing heavily in developing economies such as China, and there have been heavy net investment outflows in recent years.

But between 1995 and 2004 the US received \$1.4 trillion worth of inward FDI. Indeed, total inflows to the US exceeded the combined amounts of the world’s number two, three and four FDI destinations by a wide margin.

So, despite its deep-seated problems, the US looks like being able to hold its own against China, economically as well as militarily and in culture and science. Not Europe, I’m afraid.

Slowly but surely, economic and demographic pressures, combined with a stark decline in scientific and educational achievement, will condemn Europe to becoming first a military, then an economic, then an educational backwater and finally even a cultural backwater. In our lifetimes, we are witnessing the eclipse of Europe.

Remember: academic and scientific excellence soon follow economic prowess and China already produces 3m graduates a year, 250,000 in engineering¹⁶. In Britain, we can't even find enough people to teach physics in our schools.

Beijing University this year found its way onto The Times Higher Education Supplement's list for the top 10 universities for engineering and computing. British universities expand their courses in media studies.

No European university is in the top 20 world universities. Europeans still collect Nobel Prizes for research; but largely at American universities.

Over the next few years universities that nobody at Balliol or Christ Church has ever heard of will surge to the fore.

With growing economic prowess comes, of course, military power. The Pentagon believes¹⁷ Chinese military spending is \$90bn

¹⁶ Peter Mandelson speech, Sep 2005

<http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/484&format=HTML&aged=0&language=EN&guiLanguage=en>

¹⁷ The Pentagon's concerns are laid out in its 2005 annual report to Congress about China's military capabilities.

today, and will double by 2015. It regards China as the biggest military spender after Russia – though the US easily outspends the two of them combined.

By stark contrast, European governments continuously slash defence budgets, effectively abdicating any global military role, preferring instead the nebulous concept of soft power.

Even Europe's cultural power and influence is on the wane. There was a time when dining out in French or Italian restaurants was considered the daring and refined thing to do, especially in London and New York.

Today Asian and Latin American influences are at the cutting edge of global cuisine, while traditional European food has waned.

You doubt this is happening? Then who would ever have thought that London, thanks partly to its huge Asian culinary influences, would become a better place to dine out than Paris?

Still in doubt? Then remember that French wine producers, once the epitome of all that was best in wine, have already been seriously hurt by the onslaught from New World producers.

Be in no doubt this is the future: all of these cultural shifts away from Europe are most pronounced among younger people, especially those in their 20s and 30s.

It is now clear that the 19th century was Europe's century of dominance, the 20th century when Europe lost its dominance, forced to rely on America's help to save it from itself.

The 21st century will be the Asian-American century, with only the US rivalling China and India in economic, military, educational and cultural power.

We are at an historic and global inflection point with enormous implications for the European Union – which our governing elites seem determined to ignore.

Like many politicians before them they are slaves to an out-dated and discredited economics.

The belief that the more 'integrated' the economies of the EU become, the more it will prosper as a global bloc has been the *leitmotif* of my generation and the one before it. It is

becoming increasingly hard to sustain as a serious argument.

High social wage costs, which make it costly to hire and impossible to fire when circumstances change, have created a huge pool of unemployment.

This, in turn, has raised the cost of the welfare state and produced an ever-increasing underclass, especially – but not solely – among the offspring of immigrants.

Add to that a general cultural decadence among the influential chattering classes that denigrates hard work, self-betterment, independence, success and the traditional bourgeois virtues – and you hardly have a formula for meeting the Chinese challenge.

As France's Nicholas Sarkozy recently commented, the European social model, which the Euro-elite still thinks the envy of the world, is neither a "model" – nobody is copying it – nor very "social", given the level of unemployment.

10% in France, Germany and Spain, concentrated among the young in all three

countries, the unskilled and ethnic minorities and helping to trigger riots and Islamic extremism¹⁸. In those parts of Paris that rioted, youth unemployment is over 40%.

There is little hope in sight. Since the launch of the euro¹⁹, economic growth has slowed to under 2% in the euro zone – against over 2.5% for both the UK and OECD average²⁰. Things are not expected to get much better next year.

You don't need to be a Hayekian to see that Europe is crying out for a programme of far-reaching reform. But none is forthcoming. Indeed *rigor mortis* seems to be setting in.

Instead of a new, reforming government, Germany is being ruled by a grand coalition whose first act has been to raise taxes, which could condemn the country to recession.

France's political establishment is likely to be even more cautious in the wake of the riots.

¹⁸ Standardised unemployment data forecast average for 2005 compiled by OECD published in its Economic Outlook 77, June 2005 Annex Table 13. Can be downloaded as an Excel file on <http://www.oecd.org/dataoecd/5/47/2483871.xls>

¹⁹ Exchange rates were fixed in 1 Jan 1999

²⁰ Data from OECD, *ibid*, Annex Table One

Italy looks like it is about to exchange Silvio Berlusconi for Romani Prodi, which might be a step up for honesty but is certainly a step back for reform.

Hayek would conclude, grimly, that the EU is in a *cul-de-sac* of stagnation, decline and global eclipse. Run by a political elite that eschews reform. Determined, it sometimes seems, to turn Europe into a mixture of a museum for Asian and American tourists and a retirement home for its own aging population.

So where does this leave Britain? Hayek would say that we have a Fatal Conceit of our own.

That we can continue muddling along, mentally half in, half out of Europe. With an economy that is gradually becoming more Europeanised, at a time when the world is turning away from Europe and the European way of doing things.

It has been one of the great mysteries of the Blair-Brown Duumvirate these past eight years that the more they talk about the virtues of American-style enterprise, the more they have pushed Britain into the European social model.

11 Downing Street in particular has been occupied by Dr Jekyll and Mr Hyde. Dr Jekyll talks the Hayekian talk of markets, dynamism,

enterprise; but Mr Hyde walks the walk of European-style tax-and-spend and regulation.

I assume Mr Brown, an intelligent man, knows what he's doing, even if he won't admit it. I suggest Mr Blair, whose grip on economics is tenuous, might not be aware of what has happened on his watch.

That Britain is becoming more like Europe, for all the rhetoric to the contrary, cannot be in doubt, though few in an increasingly economically illiterate media seem to realise it.

The most recent figures from the OECD show that British public spending has surged from almost 38% of GDP in 2000 to a predicted 44% this year; and a European-style 45% in 2006.

The public spending gap between formerly lowish-spending Britain and the high-spending Euro zone has narrowed from 10 points of GDP five years ago to under four points by next year.

In terms of tax-and-spend and regulation, which research published this week shows has added over £30bn to the cost of doing business in this country since 1998, Britain can now be

regarded as close to the mainstream European social model.

Now you can regard this process as good or bad, depending on your politics and your attitude to Europe. If it wasn't happening by such sleight of hand, we might even have a national debate about it.

But those who believe this trend to be a "good thing" need to explain why it is in Britain's national interest to adopt the trappings of a social model that the wisest in Paris, Berlin and Rome wish they could drop – and which nobody else in the world is copying.

It is not easy to have a sensible debate about this. Those who raise tough questions about Europe are still dismissed as Little Englanders. In an age of globalisation, Hayek would have said that the greater evil is the predominance of the Little European mindset at the heart of our political.

The British Establishment view is still parroted repeatedly by politicians on the left and right and unquestioned by a broadcasting establishment which shares their worldview.

It is that the UK has no credible alternative to the EU. That the European Project, blessed by

historical inevitability, will produce economic growth and political tranquillity.

A slightly more sophisticated addendum to this view is that it is just a matter of time before the EU finally embraces a version of Hayekian liberalism. If ever there was a Fatal Conceit, it is this.

For over 30 years, politicians as diverse as Ted Heath, Robin Cook, Douglas Hurd, Tony Blair and Michael Hesletine have assured me we were “winning the arguments” in Europe. There were times when I even believed them, just as a wee lad I believed Scotland could win the World Cup.

Through bitter experience I now suspect there is more chance of Scotland winning the World Cup than Britain winning the arguments in Brussels!

But then the British foreign policy establishment has a habit of being in the wrong place at the wrong time.

At the end of the 19th century, it was so preoccupied with some of the more obscure outposts of the British Empire –Afghanistan, Iraq, the Sudan – as well as the rather more serious matter of the rise of Germany, that it

devoted almost no intellectual energy to the consequences for Britain of the emergence of the United States a superpower. Foreign Office files are almost empty of such considerations.

Today the British foreign policy establishment is similarly myopic: London is awash with think-tanks about Europe, but bereft of much expertise on China; while young Foreign Office mandarins still wax eloquent about, you've guessed it, Iraq, Afghanistan and the Sudan, precious few are giving any thought to the rise of China.

For an ambitious Oxbridge graduate who joins the Foreign Office today, speaking French and being posted to Paris is still seen as the fast-track to the top. The idea that high-flying mandarins should now actually be taught Mandarin and regard Beijing or New Delhi as more important than Paris or Berlin is still anathema.

Belatedly and inadequately, China is now on the British radar screen; even Mr Brown pays ritual obsequiance to it in his speeches. But Hayek would have regarded the response as pathetic.

Talk of taskforces, targets and a “national response” to China would have had him chuckle.

Setting an *official* goal to double exports to China within 10 years would have had him rolling in the aisles, a classic case of the Fatal Conceit.

The idea that the proper response to China is a set of McKinsey-style nostrums would have been proof positive for him that our government classes had no idea what was at stake. In Beijing they no doubt regard it as a manifestation of our peculiar sense of British humour.

But, again, Britain’s response is very much in the European mainstream.

Hayek would have been astounded and dismayed that Europe's leaders still spend so much of their time – and so much of our money – arguing about the Common Agricultural Policy, a subsidy programme designed to placate French farmers after the Second World War.

Devoting millions of man-hours to a Constitution that enshrined the very social

model that is condemning Europe to continued decline.

Speaking endlessly about greater defence cooperation, while cutting military budgets at every opportunity.

I suspect the radical in Hayek would force him to an unfashionable conclusion: that the entire EU project has become a giant and unaffordable distraction.

In the grand scheme of things, he would have regarded most European discussions as trivial and parochial, with no relevance to any of the great challenges facing Europe in the 21st century.

Consider, he would have said, the inordinate amount of Britain's political and intellectual capital diverted and squandered into dealing with European matters, including the 100,000 or so pages of the *acquis communautaire* -- when the rise of China, India and East Asia is what requires our attention.

Hayek would have had the guts to say the emperor has no clothes.

Hugely expensive farm subsidies are here to stay.

Protectionist sentiment will remain strong, if anything get stronger.

Supply-side reforms will remain elusive.

Second-rate military capabilities – armies that can't fight, weapons that don't work – seem inevitable.

These, Hayek would say, are the givens of the European firmament for the foreseeable future.

Even Europe's 10 newest members, supposedly more market-minded, have failed to shift the balance of power in any real way.

So, I ask again in my imaginary conversation with Hayek, what of this septre'd isle? I fear his answer would be unpalatable to our political classes and media opinion.

He would be in no doubt that, if Britain was to meet the challenge of Asia in the 21st century, its future could not lie in ever greater integration with a European continent in economic, social, cultural and geopolitical decline. Nor in becoming the 51st state of America, as some like to sneer is the only

alternative to Europe, because they know it is so unpalatable.

Hayek would have been blunt: Britain should regain its right to set global trade and military alliances, building on its position as an international trading nation and a financial and business crossroads to the world.

Government policy should not respond to China as such, he would say, but strive to become a low-tax, high-skill, well-educated, high-productivity vibrant nation-state just offshore the highest-taxed, increasingly low-skilled, sclerotic set of rich nations in the world. The ability to compete with China would follow naturally.

All this, of course, would require a Hayekian cultural revolution that our political system is not yet capable of contemplating.

A reorientation of British foreign policy away from Europe towards Asia and Latin America.

Unilateral free trade, regardless of the policy in Brussels.

A radical programme to liberalise the British economy.

A radical reduction in tax and public spending as a share of the economy.

A flat tax to remove the poorest from tax altogether and encourage entrepreneurial flair.

The injection of choice and competition into the public sector on a scale yet not contemplated.

A radical programme of Welfare reform, Wisconsin-style, accompanied by a transformation in policing to re-establish the rule of law in our inner cities.

Excellence in schools with vouchers for all, so that merit rather than money determines the quality of your education, producing a genuine meritocracy that ends the current scandalous waste of talent that blights our education system.

The rescue of British universities from the dead hand of a miserly state which cannot fund them properly and the creation of a UK Ivy League.

Such a Hayekian programme for the 21st century is a tall order; I am not sure we have the stomach for it.

But Hayek would have seen it as a stark choice (he was good at that).

Either continue with the Fatal Conceit and totter towards inevitable decline and eventual oblivion.

Or make the radical embrace of change and dynamism to ensure a prosperous future in the 21st century.

The IEA, which has done so much to reverse the march of post-war collectivism over the past three decades, could be forgiven for thinking as the last century came to an end that its work was done.

If the spirit of Hayek is to remain strong in the 21st century, I suspect its work is only just beginning.