KEYNES HAYEK: THE CLASH THAT DEFINED MODERN ECONOMICS

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As the Luftwaffe targeted culturally-rich cities in 1942, two economists took their turn in fire-watching on the roof of King’s College chapel. Thus opens an account of ‘history’s greatest economic duel’. With his journalist skill, Nicholas Wapshott gives a vivid account of a personal/professional relationship that underscores continuing debates over monetary and fiscal policy. Pignancity is gained as his narrative cites policies adopted across thirteen US presidencies. His market is clear: a copeditor is credited for turning ‘English-English into American-English’.

The author’s adjudication of the clash between Keynes and Hayek is far from impartial. Readers are led from the outset. Keynes had a ‘commonsense understanding’, whereas Hayek’s was ‘intellectual rather than practical’. Keynes saw economics as ‘a means of improving the lives of others’, whereas Hayek was ‘consumed by economic theory for its own sake’. Keynes confronted ‘real-life dilemmas’, whereas Hayek indulged in ‘pure theory’. To a degree, this is as understandable as it is common. Few master either the depth of Hayek’s work or the contrast between Keynes’s General Theory and Keynesianism. Yet each is essential to any worthwhile appraisal of the clash that defined modern economics.

The significance of eight weeks in Zurich (1919–1920) to Hayek’s Sensory Order and the relevance of that paradigm to Hayek’s analysis of a complex socio-economic order are missed. Instead, the trite categorisation of ‘devotees of the free market’ is reflected in multiple entries for ‘laissez-faire’, none of which cites Hayek on the emptiness of the term: ‘nothing has done so much harm to the liberal cause as the wooden insistence of some liberals on . . . the principle of laissez-faire’. Indeed, the ‘laissez-faire’ blunderbuss conflates policy directed towards managing real macroeconomic forces (abhorrent to Hayek) with policy to achieve monetary stability (which took Hayek’s attention over many years).

The representation of torture (Hayek) and hare (Keynes) sits awkwardly with the suggestion that, by 1929, ‘both men were well advanced toward honing their competing views’. As the hare’s General Theory (1936) displaced his two-volume Treatise (1930), the tortoise was leaving only cryptic clues (in 1931, 1933, 1935, 1939 and 1941), none of which would support the illustration that investment projects are abandoned because there is no demand ‘for ice cream’ by the time ‘ice trays for commercial refrigerators’ are complete. The exact opposite holds: by Hayek’s business cycle theory, ‘higher order’ capital projects are halted because the demand for final goods becomes too urgent. That said, a chapter which details Hayek’s four LSE lectures is lively and informative; but the suggestion that these arguments ‘would indirectly provide the foundation for the monetarist counter-revolution’ is far-fetched.

The precarious state of Britain’s exchequer in 1931 is redolent of Europe circa 2012: as Britain’s debts were ‘backed’ by gold, those across Europe are ‘backed’ by the euro. As the exchange value of sterling came under pressure, many European sovereign debt auctions are shunned. Then, as now, severe cuts in public expenditure are a prerequisite for international loans; and Keynes’s criticism that, ‘replete with folly and injustice’, cuts would cost ‘the exchequer far more than it hoped to save’ remains a contentious issue of debate. Left ‘so angry that his thoughts were unprintable’, Keynes then had to deal with Hayek’s lengthy refutation of his world view; and with Hayek’s criticism that he had been insufficient ‘effort to understanding those fundamental theorems of “real” economics on which alone any monetary explanation can be successfully built’.

Hayek’s (first part) review of Keynes’s Treatise on Money opened a series of exchanges, the details of which are variously reported. Among the confusion, ‘forced saving’ repeatedly surfaced as a conceptual root of misunderstanding. The author’s attempt to examine its importance is flawed and an implicit concession is missed; that is, in consequence of the rising prices of consumption goods, Keynes’s General Theory acknowledges the (conceptually identical) ‘postponement of consumption’.

In order to end his exchanges with Hayek, Keynes resorted to a hired accomplice (The Italian Job: Piero Sraffa); but this new engagement perplexed even the cleverest minds, including that of Frank Knight: ‘I haven’t seen anyone who could tell what Sraffa and Hayek were arguing about’. As this ‘ill-tempered’ side duel saw Hayek ‘stuck’ in believing that the economy could be understood only ‘by considering the interaction of individuals in the market place’, Keynes was ‘making a breakthrough’ and creating a ‘profound difference’ in delivering ‘practical remedies’. As the ‘progressive’ Keynes focused upon ‘a more humane future’, Hayek buried himself in abstract theories.

Richard Kahn’s delivery of the income multiplier is detailed and readers must wonder (depending on their perspicacity) either how this amazing device was not recognised earlier; or how it could ever be taken seriously. With business investments, resources are redirected to create desirable goods and services (with desirability signalled by revenue that conserves value through capital amortisation). With deficit-financed investment, sovereign
debt ever accumulates. These are fundamental objections to the income multiplier which, in the depths of the Great Depression, Keynes believed might be set aside.

The multiplier shares its star billing with Keynes’s liquidity preference interest rate theory, which proved an embarrassment even to his followers. Without short-term financial speculation it explains nothing so that, in equilibrium, there is no theory; a point presumably too abstract for the author.

The first and last we hear of a very important distinction is that, by his premature death, Keynes’s ‘revolution’ was left ‘in the hands of Keynesians. No longer would they be tempered by his wisdom’. Implicitly, the author has no view of the impact of that loss, because Keynes and Keynesianism are conflated throughout. Forty years on from The General Theory, we are told that ‘[t]he Keynesians’ belief that it was impossible for unemployment and inflation to rise simultaneously was shown to be false’. Correction: that charge would be one for Keynes himself to answer. However, Keynesianism did follow upon that track with its proliferation of largely irrelevant ‘fixed-price models’. The author gives no attention to Keynes having no ideas for an economy once it had been ‘managed’ to full employment: ‘Of course, I do not want to see money wages forever soaring upwards to a level at which real wages cannot follow. It is one of the chief tasks ahead of our statesmanship to find a way to prevent this’.

Although Hayek’s ‘Economics and knowledge’ (1937) is credited with breaking new ground, it is erroneously represented as a conversion from a belief that an economy could reach a point of stationary equilibrium. In Hayek’s published work, equilibrium is consistently represented as a dynamic tendency.

A quarter-century of ‘Hayek’s Counterrevolution’, which coincided with stagflation and the rise of Friedman’s monetarism, was ended by the financial crisis of 2008 whereby Alan Greenspan’s ‘Great Moderation’ was brought to a shuddering halt. While the response ‘initiated by George W. Bush and continued by Barack Obama, was thoroughly Keynesian’, it provided no panacea. Nevertheless, in the author’s view, Keynes had saved capitalism a second time; and with his final comment on the ‘clash’, he steps back from the detail in citing J. K. Galbraith. Unlike those who hold fast to ‘true principle’ and who prefer to accept ‘idle plants and mass despair’, Keynes’s efforts were directed to ensure the survival of capitalism; so that, if capitalism ever were to succumb to collectivism, this would constitute a ‘final victory over people like Keynes’.

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