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**FROM THE PAST TO THE FUTURE:
IDEAS AND ACTIONS FOR A FREE SOCIETY**

CHAPTER TWELVE

KEYNES V HAYEK: THE FOUR BUTS....

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Keynes v Hayek: The Four Buts....

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You all know about Hayek's *Road to Serfdom*, his great anti-central planning polemic of 1944, which inspired the foundation of the Mont Pelerin Society. Perhaps less familiar is the letter Keynes wrote Hayek on reading the book. 'In my opinion it is a grand book...morally and philosophically I find myself in agreement with virtually the whole of it; and not only in agreement with it, but in a deeply moved agreement'.ⁱ Surely, this effusive endorsement -a publisher's dream blurb - would have qualified Keynes for membership of the Mount Pelerin Society? But Keynes, as always, chose his words carefully. Moral and philosophical agreement by no means implied political agreement. Keynes's letter contained four important 'Buts...' My talk today is about those BUTs, which are as worth discussing today as they were in 1944.

The First 'But...'

'What we need, therefore', Keynes wrote to Hayek, 'is not a change in our economic programmes, which would only lead in practice to disillusion with the results of your philosophy, but perhaps even....an enlargement of them'. Here Keynes raises the crucial question of the nature of the inoculation needed against the collectivist virus. Keynes wanted to inject a limited amount of what they both called 'planning' into the economy to protect the patient from its virulent form. Hayek claimed that Keynes's vaccine was bound to bring on the full blown disease. Keynes, in turn thought that Hayek's intransigent resistance to any encroachment on market allocation was likely to bring on the very evils it claimed to prevent. This was the nub of the issue between them.

Hayek, as is well known, wanted to allow slumps to run their course. In his view they were caused by excessive credit, leading to a distorted structure of production, which was bound to collapse when the economy ran out of saving to complete the investments. To inject more credit into a diseased system would only make the disease worse. The malinvestments had to be liquidated for healthy growth to resume.ⁱⁱ Although Nazi Germany was, together with Soviet Communism, the epitome of the serfdom against which Hayek warned, his classic book never mentioned the Great Depression But Keynes's policy proposals

were framed by it. And in my view rightly so. The figures speak for themselves.

In 1928, the National Socialist Party won just 2.6% of the votes in the elections for the Reichstag. Lord D'Abernon, British Ambassador to Germany in the 1920s, wrote in his diary in 1928 that 'Hitler has faded into oblivion'.ⁱⁱⁱ In 1930, the Nazis got 18% of the vote, and in 1932 37%..Since the Depression was never central to Hayek's account of the success of fascism, he failed to give any credit to FDR's New Deal in preventing the the growth of fascism in the USA.. In his view,Hitler and Roosevelt were cut from the same collectivist cloth, which led an American reviewer of Hayek's book to point out acidly that 'the preparation for an electrocution and for an electrocardiograph is the same, up to a point'.^{iv}

Inflaion was always the danger against which Hayek warned, never unemployment, which was derivative of a prior inflation.

This issue is far from dead today. Were western governments right to bail out their banking systems in 2008-9? Were the vast stimulus packages led by the USA and China the right response to that crisis -or should they all have swallowed the Hayekian medicine and let the insolvent banking system fail? . This, of course, is as much a political as an economic question.

Then there is the question of prevention. Hayek believed economies were naturally stable in the absence of monetary distortion. Keynes thought they were naturally unstable, and needed to be stabilised by policy.I don't believe economics is any closer to resolving this question.

The Second 'But....

'You admit...that it is a question of knowing where to draw the line. You agree that the line has to be drawn somewhere, and that the logical extreme is not possible. But you give us no guidance whatever as to where to draw it....I should guess that according to my ideas you greatly under-estimate the practicability of the middle course. But as soon as you admit that the extreme is not possible...you are, on your own argument done for, since you are trying to persuade us that so soon as one moves an inch in the planned direction you are necessarily launched on the slippery path which will lead you in due course over the precipice'.

The point Keynes was making was surely correct: that Hayek's defence of liberty was pragmatic, not principled. This criticism hits home for many

circumstances force a choice upon us, and responsibility for the arrangement of our own life according to our own conscience, is the air in which alone moral sense grows and in which moral values are daily re-created in the free decisions of the individual'. Here is surely a case of confusing 'more than a bit' economic choice with moral choice. Hayek believed that the moral sense grows out of material necessity, and that in promising to abolish poverty -and thus the economic problem - the collectivists were extinguishing moral choice. 'A movement whose main promise is the relief from responsibility cannot but be anti-moral in its effect', he wrote.^x The reassertion of the primacy of scarcity, and frequent attacks on the 'false promise' of 'potential abundance' thus seem foundational to Hayek's concept of morality.^{xi}

This was quite contrary to Keynes. Keynes had argued, in his essay *Economic Possibilities for our Grandchildren*, published in 1930, that the potential plenty made possible by technology would reduce the importance of the value of economic efficiency, enabling people, for the first time in history, to live 'wisely, agreeably, and well'. In other words, the conquest of poverty would, for the first time, enable humanity to quit the realm of necessity and enter the realm of freedom.

Despite the fact that Hayek had taken another side-swipe at Keynes, Keynes's letter was impeccably courteous. Hayek would appear less of a Don Quixote, he wrote, had he coupled his attack on central planning with the argument that we would not need it, because the economic problem which it claimed to solve, would have been solved by capitalism anyway.

Conclusion

Hayek thought of Keynes a great man, but not a great economist. Keynes thought *The Road to Serfdom* a 'grand book', but little of Hayek's economics. How might they have continued the argument had Keynes not died in 1946.

The debate about the validity of their economics remains open. It hinges on the question of the extent to which full employment is the normal or strong tendency of a decentralised system. Hayek thought it was; Keynes thought it wasn't. Both could appeal to the facts to support them. Hayek could point out that the capitalist market economy had been the major factor in lifting the world out of poverty and reducing violence, Keynes to the fact that it achieved full employment only in 'moments of excitement'; that its progress was punctuated by crashes

which periodically threw millions out of work; and that the capitalist era had witnessed two of the most devastating wars in history.

The two men might have continued to debate about whether the malfunctions of the market system were the result of external interference, as Hayek supposed, or inherent, with certain kinds of interference being needed to correct them, as Keynes claimed. Such arguments would have continued to turn on the amount of knowledge or information available to economic actors. Both agreed on the importance of ignorance in human affairs. But whereas Hayek contrasted the ignorance of the central planner with the dispersed knowledge of individual market transactors, Keynes stressed the ignorance arising from uncertainty. Thus whereas Hayek thought of economic intervention as destroying knowledge available in markets, Keynes thought of it as reducing the uncertainty which made markets unstable.

But in the nature of the case, this disagreement could not have been settled by the facts, because economies work under different institutional conditions, different conditions of knowledge, and one is never properly able to compare like with like. Keynes would have pointed to the economic success which marked his twenty-five epoch of moderate planning, and the renewed instability which accompanied its rejection after 1980. Hayek would have countered with the inflationary crisis which ultimately engulfed the Keynesian revolution and the 'Great Moderation' of the 1990s and early 2000s. What would they have made of the crash of 2008-9, quantitative easing, and the current move back to fiscal policy?

The question where to draw the line is still very much alive. Keynes was in favour of limited intervention to secure full employment. But Keynesianism mutated into Keynesian social democracy in the 1960s, with state spending creeping up to 40-50 per cent of national income. For Hayek red lights would have flashed: here, he would have told Keynes, was the slippery slope. Neither man's philosophy told you where it was safe to draw the line. This is something we must work out anew.

The debate on the morality of capitalism is still far from over. Keynes himself admitted that the poverty problem still plagued most of the world, so he might have conceded that Hayek's scarcity perspective could not be entirely jettisoned. But how would Hayek have reacted to the fact that it is capitalism's rampant consumerism, not collectivism, that has been weakening the moral values for which he stood? And how

libertarians who deplored Hayek's concessions to what they would call socialism (Ayn Rand denounced him as a 'compromiser') According to Anthony de Jasay, Hayek's social order has no clear line: 'it permits, if not positively mandates, the state to produce any number [of public goods] in any quantity; the state's place in society is consequently *ad hoc*, open-ended, indeterminate, and no amount of dire warnings against socialism, fatal conceit, and loss of freedom will make it more determinate'.^v

According to Hayek, government in all its actions must be bound by rules 'fixed and announced beforehand'. The rule of law had to maintain procedural, not substantive, justice; formal, not substantive equality. The difference was between laying down the rule of the road as in a highway code, and ordering people where to go. Thus the rules should be quite general, and not be aimed directly at benefitting or harming specific groups or bringing about particular situations. This justified coercive anti-monopoly legislation; it ruled out racial discrimination.

In chapter 9 Hayek implicitly acknowledges that the capitalist system fails to provide sufficient social security, and devotes several pages to the need for minimum security provision 'outside the market'.^{vi}

Although Hayek's commitment to freedom cannot be doubted, his critics were right to point out that he offered no principled defence of individual liberty. His general rules offered no assurance against extreme coercion provided all were coerced equally, for example, his endorsement of conscription, as against Keynes, who took a principled stand against conscription in the name of individual liberty.^{vii}

Libertarian critics of Hayek were right, therefore, to argue that Hayek offered no principled defence against state encroachment on individual liberty, only a contingent defence based on the knowledge limitations of the central planner. The big give away is the passage in the *Constitution of Liberty* (1960), when Hayek said that if men were omniscient 'there would be little case for liberty'.^{viii} Keynes's rights-based philosophy offers a stronger protection of liberty than Hayek's quasi- utilitarian defence.

The Third 'But...'

‘Dangerous acts can be done safely in a community which thinks and feels rightly, which would be the way to hell if they were executed by those who think and feel wrongly’ .

What Keynes is saying here is that moderate planning of the type he was advocating need not lead to serfdom in a country with a liberal tradition; American critics of Hayek made exactly this point, pointing to the different political traditions of Britain and the United States and Russia and Germany.

Keynes’s argument is not as convincing as it seems at first sight. It was clearly safer to have Churchill running the war than Hitler, even though the wartime organisation of Britain and Germany was similar. But this was a static argument. It assumed that the evolved political language of the community was proof against coercive state interventions. But the language is affected by the intervention, and the appetite grows with the feeding. . A society in which ‘dangerous acts’ by governments become continuous will lose its understanding of why they are dangerous –that is, its sense of what it is to be free. And this has happened to some extent. To give just one example: today we accept levels of state surveillance which would have been unthinkable even twenty or thirty years ago, comforting ourselves with the thought that the surveillers are men and women of goodwill. This is a pretty ominous slippery slope, and Hayek was right to warn against it.^{ix}

The Fourth ‘But....’

‘ No, what we need is the restoration of right moral thinking -a return to proper moral values in our social philosophy. If only you could turn your crusade in that direction you would not look or feel quite so much like Don Quixote. I accuse you of perhaps confusing a little bit the moral and the material issues’.

This cryptic passage needs some unpicking. Keynes’s criticism is that Hayek was too willing to sacrifice ‘moral values’ to those of economic efficiency. The contrast he wanted to draw was between the ‘scarcity’ and the ‘abundance’ perspectives.

For Hayek, scarcity was the condition of freedom, for it required the exercise of choice. This was the classic perspective of economics, enshrined in Robbins’ definition of economics as the science which studies human behaviour ‘as a relationship between ends and scarce **means** which have alternative uses.” Hayek in turn writes ‘Freedom to order our own conduct in the sphere where material

would Keynes have responded to the re-emergence of scarcity in rich countries in the form of climate change and potential exhaustion of natural resources? The two old fogies might have found more common ground in deploring the decay of capitalist civilisation than they managed in 1944.

A broader ground for debate would have concerned the legitimacy of the capitalist market order, its ability to maintain consent. The argument seemed to have been settled in favour of Keynesian social democracy; it then veered back towards a Hayekian view; now, with the populist assault on the liberal values of free markets and the rule of law, the question is open again, with Hayek's indifference to unemployment and social inequality exposed as major political weaknesses of the post-Keynesian order.

In the end, you can't prove either Hayek or Keynes to have been right. Social democracy did not collapse into serfdom. But Hayek guarded himself against this. He wrote that 'the democratic statesman who sets out to plan economic life will soon be confronted with the alternative of either assuming dictatorial powers or abandoning his plans'. By the 1970s there was some evidence of the slippery slope...and then there came Reagan and Thatcher. Hayek's warning played a critical part in Thatcher's determination to 'roll back the state'. Equally, though, Keynes had earlier given liberalism an economic agenda to fight back against socialism and communism, by demonstrating that societies didn't need 'serfdom' to secure full employment.

Both were lovers and defenders of freedom. In 1944, Keynes had the grace to acknowledge Hayek's role in its defence, while Hayek, with fifty years for further reflection, never had the generosity of spirit to acknowledge Keynes's. (2867)

ⁱ Keynes to Hayek, 28 June 1944. Reproduced in vol. 27 of *The Collected Writings of John Maynard Keynes*, pp.385-8. Keynes had read *The Road to Serfdom crossing the Atlantic on his way to the Bretton Woods Conference*.

ⁱⁱ I have seen no convincing evidence that Hayek ever retracted this view. In his memoirs, *Autobiography of an Economist*, 1971, Lionel Robbins wrote (p.154) that Hayek's remedy of letting depressions run their course was 'as unsuitable as denying blankets and stimulants to a drunk who has fallen into an icy pond, on the ground that his original trouble was overheating. In his *The General Theory of Employment, Interest and Money*, 1936, p.20n, Keynes paid a backhanded compliment to Lionel Robbins, then the British cheer-leader of the Austrian school, that he 'almost alone, continues to maintain a consistent scheme of thought, his practical recommendations belonging to the same system as his theory'.

ⁱⁱⁱ Lord D'Abernon, *An Ambassador of Peace, 1929-30*, ii, pp.51-2n.

^{iv} T.V.Smith, *Ethics*, vol.55, no.3, April 1945, pp.224-6

^v Anthony de Jasay, 'Hayek: Some Missing Pieces', *Review of Austrian Economics*, vol.9, no.1.1996, p.113. Jasay argues that Hayek's views on state intervention were dominated by his aim of making the market system politically attractive.

^{vi} F.A.Hayek, *The Road to Serfdom*, 1962 paperback ed), p.99. All quotations are from this edition.

^{vii} Of the attitude of the two men towards conscription, see Hayek, *The Constitution of Liberty*, 1960, p.153, where he writes that conscription, by being enforced on all is largely deprived of the 'evil nature of coercion', and Keynes who a 'conscientious objection' to surrendering 'my liberty of judgment on so vital a question as undertaking military service'. (q.Robert Skidelsky, *John Maynard Keynes: Hopes Betrayed 1883-1920*, 1983, pp.315-6.

^{viii} Hayek, *Constitution of Liberty*, p.29

^{ix} Eg., Hayek, *Road to Serfdom*, p.101, and ch.xi. *passim*

^x

^{xi} For Hayek's attacks on the doctrine of 'potential abundance' see *ibid.*, pp.19,78,15.,



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