Nicholas Wapshott, *Keynes Hayek. The Clash That Defined Modern Economics* (Scribe, 2011)

Reviewed by Selwyn Cornish[1]

Opinion about the role that government should play in the macro economy tends to conform to a rhythm, an ebb and flow, determined by circumstances and influenced by ideas. This book examines the ideas of John Maynard Keynes and Friedrich Hayek from the 1920s to the present and concludes that interest in their theories and policy proposals waxed and waned according to changes in economic conditions. It is at once a study of the development of modern macroeconomic theory and policy, and a review of competing political philosophies. The author is a Reuters contributing columnist and former senior editor at *The Times* of London. He writes with an engaging style and adopts a light touch, calculated no doubt to attract a wide audience. The book, to be sure, is a good read. But historians of economic thought — and economists in general — will be disappointed perhaps with the superficial nature of much of the argument. Yet the book may assist the general reader to understand the evolution of economic ideas, as long as it is recognised that substantial liberties have been taken to simplify the argument.

The author's intention may have been to write a book about Keynes. But there are now so many books about him, and about his economics, that it is difficult to conjure up new ways of presenting his ideas. Following the method adopted by the Greek essayist Plutarch, who wrote about parallel lives, Wapshott has come up with the idea of discussing the progression of Keynes's ideas by comparing them with those of one of his chief rivals, Friedrich Hayek. The discussion focuses in particular on the high point of their rivalry in the early 1930s. Keynes's major works in economics are first discussed and Wapshott then contrasts Keynes's conclusions with Hayek's ideas on monetary economics and capital theory. While Keynes's call for government expenditure on public works to alleviate unemployment began as early as 1924, it originally lacked an analytical foundation. As unemployment in Britain grew, Keynes spent the next 10 years trying to develop a theory to justify government expenditure on public works. On the other hand, Hayek's economics was influenced by the work of his Austrian forebears and by the hyper-inflation in Austria and adjoining countries

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in the early 1920s. This led him to conclude that government intervention in the economy led inevitably to distortions in the underlying economic structure and to inflation.

In this battle of ideas and policies, Wapshott directs particular attention to the marked divisions in the 1930s between the economists in Cambridge led by Keynes and his associates, including Richard Kahn, Piero Sraffa and Joan Robinson, and Hayek's supporters at the London School of Economics, where his great champion was Professor Lionel Robbins. In fact, Wapshott asserts that Robbins brought Hayek to London from Vienna for the express purpose of halting the spread of Keynes's influence on contemporary economic thought and policy.

The highlight of the book for many readers will be those sections that cover the exchanges between the rival parties in the early 1930s. They pulled no punches when criticising the economics of the other side. But notwithstanding the ferocious attacks on each other's work, Keynes and Hayek were able to maintain a high personal regard for each other. Keynes, for example, went out of his way to take care of Hayek and his family when they were forced to vacate London during the war and move to Cambridge. Hayek, for his part, had no hesitation in adjudging that Keynes was 'the one really great man I ever knew'. This ability to retain a high personal regard for each other while conducting a heated public debate against each other's ideas and proposals, says a great deal about the two men; it recalls the earlier debate between two other great rivals, namely David Ricardo and Thomas Robert Malthus.

While discussion of their ideas and the intellectual and personal exchanges between Keynes and Hayek and their associates absorb a significant portion of the book, the central theme is the fluctuating fortunes of their ideas and related policy positions. Thus Keynes seemed initially to win the battle, dominating economic thought and policy from the 1930s to the early 1970s. In defeat, Hayek moved from economics to political philosophy, beginning with *The Road to Serfdom* and continuing with *The Constitution of Liberty*. These publications slowly created a new interest in Hayek, which accelerated with the stagflation of the 1970s and early 1980s. Now Hayek's early writing in economics won new adherents, and in 1974 he was the joint winner with Gunnar Myrdal of the Nobel Memorial Prize in Economic Science. The eclipse of Keynes, and the resurgence of Hayek, lasted until the Global Financial Crisis in 2008. In later chapters, Wapshott records the swing back to Keynes, and then gives brief attention to the subsequent questioning of the validity of Keynesian policies as sovereign-debt crises materialised and excessive monetary easing rekindled fears about the recurrence of inflation.

As an organising conception, the differences between Keynes and Hayek might seem to be a promising device to capture the general reader's attention. The problem is that such a framework leaves open the possibility of over-simplification. An example is the stress that is placed on the idea that Keynes's economics failed when stagflation arrived in the early 1970s, since it was thought incapable of handling the co-existence of inflation and unemployment. But one only has to read Chapter 21 of the *General Theory of Employment, Interest and Money* to know that Keynes well understood the possibility of inflation occurring when the economy operated at less than full employment, which for him meant an unemployment rate of 4–5 per cent. The idea that inflation and unemployment were necessarily incompatible was taken from the so-called Phillips Curve. The apparent trade-off between unemployment and inflation, however, has nothing to do with Keynes's economics, but was rather a concoction formulated by Samuelson and Solow decades after the publication of the *General Theory*. As to policy, there was nothing 'Keynesian' about the desire of American administrations in the second half of the 1960s and early 1970s to boost government expenditure and allow budget deficits to accelerate at a time of full employment and rapid inflation. Nor was there anything 'Keynesian' about the decisions of Australian governments in the early and mid 1970s permitting the continuation of a grossly overvalued exchange rate and massive increases in government expenditure when the foreign reserves quadrupled within the space of two years and unemployment was at near record lows and inflation at peacetime highs. Here are to be found the origins of the stagflation in the 1970s, rather than the work of Keynes. Further, there is nothing 'Keynesian' about the excessive stimulus measures in 2008 and 2009 when the Australian economy was scarcely touched by the GFC, or about the continuation of these measures into 2010 and the perpetuation of budget deficits in 2011 and 2012. Rather than being inspired by Keynes, all these developments were the result of political expediency and should be seen in that light.

What then was the essence of 'the clash' between Keynes and Hayek that 'defined modern economics'? Whereas Hayek believed that attempts to subvert the market mechanism, though they might be undertaken with the best of intentions, would lead inevitability to inefficiency, unemployed resources and ultimately to the loss of freedom, Keynes believed that the market system had a tendency to operate at below capacity and required fiscal and monetary measures to boost aggregate demand.

Keynes had two major problems with Hayek; one to do with the latter's economics, the other with his political philosophy. Like members of the 'classical school', Hayek's economics was based on the implicit assumption of full employment. Perhaps the most important point that Keynes made in the *General Theory* was that when the economy operated at less than full employment — and for him, this was the general case — there were spare resources that could be drawn upon by public authorities without having to divert resources from existing employment. In this sense, the structural distortions between capital-goods and consumer-goods industries that Hayek argued would occur when governments spent on public works, or when the monetary authorities allowed excessive monetary easing, would not occur. At full employment, Keynes conceded that the classical analysis was valid; in those circumstances, market forces should be allowed to do their job, governments should scale back their expenditures, and central banks should tighten monetary policy. While Arthur Pigou, for example, had been signing the same letters to newspapers as Keynes, calling as they did for increased government expenditure to stimulate activity, Keynes criticised Pigou's continued adherence to the economics of the classical school because it presupposed that there could not be any unemployment. As Keynes wrote in the Preface to the *General Theory*: '[I]f orthodox economics is at fault, the error is to be found not in the superstructure, which has been erected with great care for logical consistency, but in a lack of clearness and of generality in the premises' (Keynes 1936). He had made the same point in 1931 when criticising Hayek, saying that his analysis 'is an extraordinary example of how, starting with a mistake, a remorseless logician can end up in Bedlam' (Moggridge 1973).

The other issue that troubled Keynes — and many others, including Frank Knight and Jacob Viner — was an inconsistency that lay at the heart of *The Road to Serfdom*. Keynes saw great merit in the book's attack on excessive government intervention. Writing to Hayek in June 1944, he considered *The Road to Serfdom* to be 'a grand book. We have the greatest reason to be grateful to you for saying so well what needs to be said…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' (Moggridge 1980). For many, however, this praise by Keynes for Hayek's most popular work has often been difficult to square with their differences on matters of economic theory and policy. But that was not the point, for when it came to politics it is often forgotten that Keynes and Hayek had much in common: both were liberals, and both saw a limited role for government in economic and social affairs. Unlike Marx, for example, the objective of both Keynes and Hayek was to preserve capitalism; that aim, according to Keynes, required the government to stabilise the economy, while Hayek supported government intervention in various areas of social policy (as did Adam Smith). Of *The Road to Serfdom*, Keynes told Hayek that his 'only serious criticism of the book' was 'the question of knowing where to draw the line' (on government intervention):

> 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. In a sense, this is shirking the practical issue. It is true

> that you and I would probably draw it in different places…But as soon as you admit that the extreme is not possible, and that a line has to be drawn, 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. (Moggridge 1980)

In 1971, after reviewing the debates of the 1930s, which to some degree he had initiated, Lionel Robbins — now Lord Robbins — wrote that the 'historian of the future, if he wishes to treat of the relations between London and Cambridge during this period, should be warned that any generalizations that he may wish to make must fit facts of considerable complexity if they are not seriously to misrepresent the situation' (Robbins 1971). Regrettably, Wapshott failed to heed this advice, since he has over-generalised and ignored the complexities involved. As to his part in the debates of the 1930s, Robbins later confessed that he 'was certainly an anti-expansionist where public expenditure was concerned, at a time when, as I now think, I should have been on the other side'. The problem was that the prevailing 'theory was inadequate to the facts'; he was prepared to admit 'my dispute with Keynes as the greatest mistake of my professional career'. Like Hayek, Robbins agreed that he 'would certainly regard Maynard Keynes as the most remarkable man I have ever met' (Robbins 1971).

One final point: there is an inordinate number of factual and bibliographical mistakes in this book. In the early 1980s the distinguished English novelist Graham Greene wrote a letter to *The Times* in which he took Wapshott to task for manifold errors in an article Wapshott had written for the paper. Rather than 'Mr Wapshott', Greene suggested, he should be described as 'Mr Badshott' (Hawtree 1989). It is a pity that Wapshott did not learn from his encounter with Greene.

References

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