

COMMANDING HEIGHTS

Friedrich von Hayek

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(1899-1992)

Born in Austria in 1899, Nobel Prize-winning economist Friedrich von Hayek was an advocate of free-market capitalism. He is known for his criticism of the prevailing economic theories of the 20th century, Keynesian economic models and socialism.

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In retrospect, it was the awarding of the 1974 Nobel Prize in economics that first captured, almost by chance, the great intellectual change. The Swedish academy wanted to honor Gunnar Myrdal, distinguished Keynesian, a father of development economics, and a great figure of Swedish socialism. But the grantors, worried about the appearance of choosing so local a favorite, decided that they ought to balance the ticket with a more conservative figure, and they awarded the prize to Myrdal jointly with Friedrich von Hayek. A good part of the economics profession was scandalized by the choice of Hayek; many economists in the United States, if polled, would have hardly even considered him an economist. He was regarded as right-wing, certainly not mainstream, even something of a crank as well as a fossil from an archaic era....

Yet the award documented the beginning of a great shift in the intellectual center of gravity of the economics profession toward a restoration of confidence in markets, indeed a renewed belief in the superiority of markets over other ways of organizing economic activity. Within a decade and a half, the shift would be largely complete. And the eventual victory of this viewpoint was really a tale of two cities—Vienna and Chicago.

Friedrich von Hayek was the figure who tied the two together; he also connected the post-World War I Austrian School of economics to the renewed embrace of markets in the 1980s. A product of the Austro-Hungarian Empire and its collapse, Hayek was shaped by the vibrant, vital culture of Vienna both before World War I and, in its more tortured form, after the war. A second cousin to the philosopher Ludwig Wittgenstein, he came from a family of biologists and government officials, and he was headed toward his father's career, botany. But then World War I fundamentally changed his outlook. As a junior officer in the war, he came face to face with the complexities and dangers of nationalistic fervor. "I saw, more or less, the great empire collapse over the nationalist problem," he later said. "I served in a battle in which

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eleven different languages were spoken. It's bound to draw your attention to the problems of political organization." The war also left him with a compulsion to find an answer to "the burning question" of how to build a "juster society."

To that end, returning to Vienna after the war, Hayek earned doctorates in both economics and law. He went to New York City in 1923 and enrolled in the Ph.D. program at New York University. But he ran out of money and returned to Vienna to continue his work in economics. The war drove him, like many of his young contemporaries, toward an idealistic search for renewal, a quest for a better world—which meant socialism. "We felt that the civilization in which we had grown up had collapsed," he later said. "This desire to reconstruct society led many of us to the study of economics. Socialism promised to fulfill our hopes for a more rational, more just world." But then, as he began to study economics, he went through a painful and reluctant reassessment, in which he concluded that his idealistic objectives could be better served through a market economy.

His transformation occurred under the influence of Ludwig von Mises, the most prominent member of the Austrian School of economics. In his book *Socialism*, published in 1922, Mises presented a devastating analysis of the central economic failing of socialism. He called it the economic calculation. The problem was that under central planning, there was no economic calculation—no way to make a rational decision to put this resource here or buy that good there, because there was no price system to weigh the alternatives. Central planners could make technical decisions but not economic ones. Over the rest of the century, that criticism would prove to be extraordinarily prescient. "Socialism shocked our generation," Hayek later said. Yet, he added, it profoundly altered the outlook of idealists returning from the war. "I know, for I was one of them.... Socialism told us that we had been looking for improvement in the wrong direction."

Hayek became Mises's student and then, for several years, his research assistant. Owing to the postwar Austrian inflation, he learned firsthand, in his very first job, what inflation could mean. He began at 500 kronen a month. Nine months later, his salary had swollen to one million kronen a month. In 1931 Hayek was invited to become a professor at the London School of Economics (LSE). The invitation was proffered by William Beveridge (who would author the Beveridge Report a decade later) but was at the specific instance of Lionel Robbins,

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the outstanding British liberal economist. In his inaugural address at LSE, Hayek declared that it was "almost inevitable" that any "warm-hearted person, as soon as he becomes conscious of the existing misery, should become a socialist." But economic study would bring that person to a more conservative point of view. This would happen to people who "have all possible sympathy with the ethical motives" from which radicalism springs and who "would be only too glad if they could believe that socialism or planning can do what they promise to do."

The London School of Economics had been founded by the Fabian socialists in 1895, and since the 1930s it had had a reputation as a leftist institution, dominated by socialists and devoted to propagating leftwing doctrines both in Britain and to the young people who went to study there from around the world. Yet by the 1930s, LSE's economics department, with Robbins, Hayek, and others, became the redoubt of traditional liberalism, battling to uphold the creed as socialism and Keynesianism became the dominant forces of the time. Hayek was at the forefront, not only the most consistent but indeed the most vocal critic of Keynes's work both before and after *The General Theory*. Keynes's approach, Hayek believed, was based on error; it would not solve the slump but would institutionalize inflation.

Indeed, in Hayek's view, *The General Theory* was not a general theory of economics at all but rather a dressed-up specific theory to get around a political impasse in Britain. Keynes was no less slashing in his rejoinders. Hayek, he said, had started in one article "with a mistake" and then proceeded to "bedlam." Another Hayek article, he said, was "the wildest farrago of nonsense." In 1933 Keynes wrote his wife about a visit that Hayek had made to Cambridge. Keynes sat next to him at dinner and then lunched with him the following day. "We get on very well in private life. But what rubbish his theory is."

As World War II progressed, Hayek became increasingly apprehensive about what he saw as the advance of collectivism, central planning, and what would become Keynesian interventionism. In one of his most famous articles, he argued that the problem of knowledge defeats central control of economies: Those at the center can never have enough information to make their decisions. Much better, he argued, was the price system, which, in "its real function" was "a mechanism for communicating information." For Hayek, it was nothing less than "a marvel." He explained, "The marvel is that in a case like that of a scarcity of one raw material, without an order being issued, without more than perhaps a handful of people

knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly; that is, they move in the right direction."

At the same time Hayek was preparing a full-scale broadside in a much more popular form—*The Road to Serfdom*. That book, which appeared in 1944, might have become a best-seller in Britain were it not for the extreme paper rationing of the war. Nevertheless, at least one copy found its way into the hands of an Oxford undergraduate, Margaret Roberts, not yet Margaret Thatcher. The University of Chicago Press published it in the United States, and Hayek's arguments went on to have much wider fame when *Reader's Digest* published a condensed version. To some degree, Hayek had to make his arguments in code, for it was not acceptable to criticize the Soviet Union, which at the time was a great ally. Even so, after World War II, the four-power-occupation authorities in Germany banned the book there at the behest of the Soviet Union.

Keynes, who read *The Road to Serfdom* while on his way to the Bretton Woods conference, wrote Hayek, more than oddly, that it was "a grand book." He added that he was in "deeply moved agreement" with the whole of it. He then proceeded to lay out his profound disagreement: "According to my ideas you greatly under-estimate the practicability of the middle course.... What we want is not no planning, or even less planning, indeed I should say that we almost certainly want more." He concluded by advising Hayek to take up "the restoration of right moral thinking." For "if only you could turn your crusade in that direction you would not feel quite so much like Don Quixote."

But after the initial splash of *The Road to Serfdom*, Hayek did rather seem a Don Quixote off on a fanciful campaign. In later years, Hayek would ruefully acknowledge that the book was too "popular" for his own academic good and had discredited him within the economics profession. The breakup of his first marriage occurred shortly after, and he married a woman he had first fallen in love with over 20 years earlier. In 1950, Hayek left LSE for an appointment at the University of Chicago. He was professor of social and moral sciences and a member of the prestigious Committee on Social Thought, where his colleagues included some of America's most stellar intellectuals. He was not part of the economics department and did not have much direct impact on students there. He struck people as very much an old-style

Central European gentleman—reserved, rather austere. When a young graduate student (much later a Nobel Prize winner) asked him to read a draft essay on economic analysis and political choice, Hayek politely declined. He did not read handwritten manuscripts, he explained.

It was while at Chicago that Hayek wrote what many consider his outstanding work, *The Constitution of Liberty*, published in 1960. In it, he further developed one of his most important themes: Laissez-faire was not enough. Government did have a clear role: to ensure the development and maintenance of the institutions—the laws and rules—that would ensure a competitive economy. And that, whatever emotion might otherwise say, remained the best mechanism for achieving the ideals that had captured him on the battlefield of World War I. Hayek never quite felt at home in Chicago. He kept a car in Paris, and whenever he could, he returned to the Alps with his new wife. Depression began to unsettle him. After a dozen years at the University of Chicago, he took up an appointment at the University of Freiburg, amid the Ordoliberals.

The Alps had already provided the venue from which Hayek would extend his influence. In 1947, he had taken the lead in convening a meeting of a remarkable group of intellectuals, mainly economists, numbering just 36. It was held at a Swiss spa on Mont Pelerin, and ever after became known as the Mont Pelerin Society. The first session was such a success that the group reconvened two years later and thereafter on a regular basis, in different locations, with ever-growing numbers. It provided a framework for like-minded thinkers to dissect socialism and collectivism and to debate and argue philosophy and policies. It also provided liberal (in the European sense) economists with the sense of an international community, with a fervor to develop their ideas, and—especially for those coming from countries where liberal economists were few and far between—the means to overcome their isolation and the comfort of knowing that they were not alone.

For Hayek, the meetings of the Mont Pelerin Society were essential bivouacs in the war of ideas. He believed that the struggle would be a long one; liberal thinking would be on the defensive "for the next 10 or 20 years, during which the present collectivist trend is bound to continue." In a paper entitled "The Intellectuals and Socialism," which he circulated after the first meeting of the society, he warned the participants that they should prepare for the

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protracted struggle, though it was one that they could win. "What to the contemporary observer appears as a battle of conflicting interests decided by the votes of the masses," he said, "has usually been decided long before in a battle of ideas confined to narrow circles."

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