

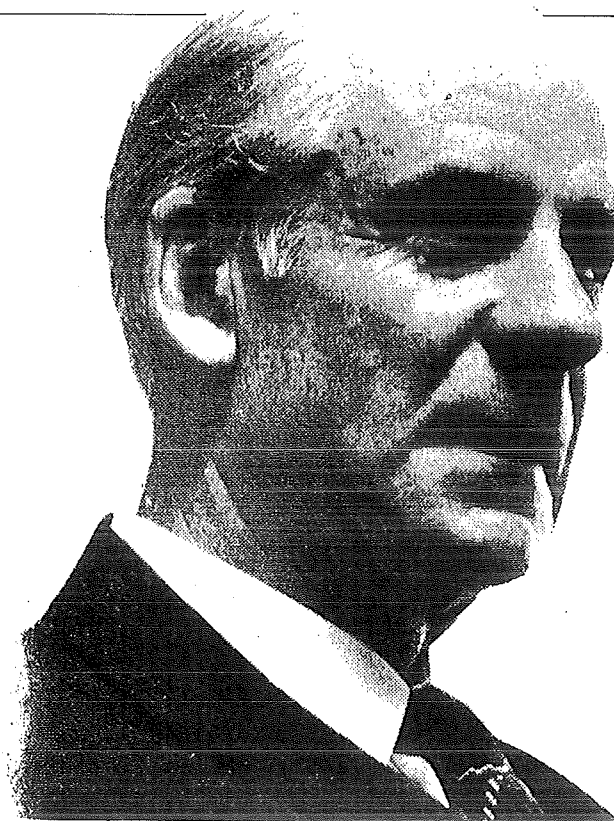
THE AUSTRIAN ECONOMICS NEWSLETTER

Volume 3/No. 3 Summer 1982

Hutt's Critique of Keynes

Two Reviews of *The Keynesian Episode*

by William H. Hutt, Indianapolis: Liberty Press, 1979, 449 pp., pb. \$4.50, hd. \$10.00.



W.H. Hutt

Reviewed by John B. Egger

The Keynesian Episode is Professor Hutt's second edition of *Keynesianism—Retrospect and Prospect* (1963). He cautions us in his preface, however, that the changes are enough to make *Episode* "a new book," and this is substantially accurate. While pages 3 through 291 of *Keynesianism* appear as pages 87 through 401 of *Episode*, about 120 pages of the earlier work are omitted and 85 pages of new material added. Even in those pages which reproduce *Keynesianism* in substance, Professor Hutt has rewritten many of its most confusing parts, adding and omitting words, phrases, sentences, and even paragraphs here and there, revising their orders, and employing a more modern style. Paragraphs are no longer numbered, terms like "whilst" have disappeared, and most of his long lists of cases have been curtailed and incorporated into ordinary paragraphs. In short, *Episode* is much more pleasant to read than its ancestor, and it's different enough that bibliophiles cannot give up their used-bookstore searches for *Keynesianism*.

The first six chapters of *Episode* deal explicitly with Keynes and "Keynesianism." The next seven, while frequently mentioning the ideas and policies of

Reviewed by Leland B. Yeager

Professor Hutt's new book began as an intended second edition of his *Keynesianism—Retrospect and Prospect*, 1963 (which, Hutt says, he had originally thought of entitling *The Curse of Keynes*). Not surprisingly, then, the book echoes familiar themes. I shall try to summarize them, not necessarily in Hutt's own terminology.

Fundamentally, behind the veil of money, people specialize in producing particular goods and services to exchange them for the specialized outputs of other people. Any particular output thus constitutes demand for other (non-competing) outputs. Since supply constitutes demand, there can be no

Keynes and his followers, are focused on the functioning of the market economy. The final five chapters zero in on popular macro concepts—the multiplier and accelerator, for examples—and discuss "the retreat" from Keynesianism by both Keynes and later economists. (Hutt is both modest and realistic enough to observe that, despite his 1963-stated hopes, *Keynesianism* has apparently had no impact whatsoever in accelerating this process.)

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fundamental problem of deficiency of aggregate demand. Any apparent problem of that sort traces to impediments to exchange of goods and services for each other—to failures of markets to clear because of wrong prices. Impediments to exchange discourage production of goods and services destined for exchange. Say's Law, as Hutt further interprets and extends it, points out why cutbacks in production in some sectors of the economy, meaning as they do cutbacks in the real demands for the outputs of other sectors, cause cutbacks of production in those other sectors also. With demands curtailed, what might otherwise have been equilibrium prices for the outputs of those other sectors are now too high; and unless these prices are adjusted downwards, they impede exchanges and production. In this way, wrong prices and production cutbacks in some sectors make existing prices wrong and cause production cutbacks in other sectors also; the rot is cumulative. In the opposite and more cheerful direction, anything that promotes market-clearing prices and the recovery of production in some sectors promotes cumulative recovery

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The *Austrian Economics Newsletter* is designed as a research and communications device for work in Austrian economics. As such, it is essential that we have the active support and cooperation of our readers. We need any information which would be of value to other Austrians and we welcome any suggestions for improving the *Newsletter*. The success of the *Newsletter* fundamentally depends on our ability to encourage the participation and involvement of our readers.

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200 Park Avenue South
Suite 911
New York, N.Y. 10003

The A.E.A. Session

Reviewed by Mark Manasco

Lately considerable interest has been aroused within the economics profession by the emergence of a revived Austrian tradition. This was never more in evidence than by a standing-room-only session at the annual meeting of the American Economics Association devoted to "Recent Developments in Economic Theory: Austrian Economics".

With the recent attempts to reconcile and incorporate Austrian insights into mainstream analysis it is particularly interesting that the session included a joint paper entitled "What is Austrian Economics?" written by two of the school's more able practitioners, Professors Mario Rizzo (NYU) and Gerald O'Driscoll (NYU) (soon to be expanded into a book to be released by Blackwell). The joint essay was one of three papers which included discussions on "Intertemporal Coordination in Macro-economic Theory" by Roger W. Garrison (Auburn) and "The Micro-foundations of the Moderate Quantity Theory" by J. Huston McCulloch (Ohio State).

In their provocative paper, O'Driscoll and Rizzo convincingly show that Austrian economics can no longer be considered a minor footnote in the history of thought, an old school whose revolutionary insights into the economic problem were long ago fused with neo-classical theory. Rather, they contend, it is a well integrated, vibrant body of thought that has much to offer contemporary economists in explanation of how markets work. In this clearly written, lucid overview of the Austrian "research program," the authors have not only argued for this favorable assessment of the modern Austrian school, they have supplied superb evidence in the form of this paper itself. This thoroughly researched, footnote-laden manuscript reveals that its authors possess a remarkably wide grasp of contemporary economics and that their school has a number of interesting things to say, both favorable and unfavorable, about recent developments in such areas as Rational Expectations theory and the Economic Analysis of Law.

The central task of the research program as seen by the authors is its attempt to "render social phenomena intelligible in terms of individual purposes and plans". As such the study of economics begins with tracing out the (often unintended) implications of human action. From the inception of the Austrian school the concept of purposeful behavior has been placed at the core of scientific inquiry. It is the origin of

investigation for it is through the interaction of planned individual actions that social institutions such as language, law, or money and the price system evolve. The object of investigation is to "recompose or reproduce the social institution under study by tracing its logical origins to the interaction of individual plans". Pursuing this logic, Rizzo and O'Driscoll contend that we merely beg the question when, as in much of modern economics, we ignore the decentralization of knowledge. Explanations that treat the relevant data as somehow given in general to society, thereby abstract from an essential element of the socio-economic problem: the fact that no single mind is in possession of all the requisite information. Analysis that proceeds in this direction tends to lose sight of the crucial process and role that knowledge and information play in decision making.

The notion of subjectivism which the school has at times been characterized as having an unabiding obsession with is rigorously derived from the concept of purposeful behavior. Subjectivism is but the logical extension of placing economic ends and means—strictly as perceived by the actors themselves—at the heart of economic analysis. O'Driscoll and Rizzo have skillfully woven the basic themes of purposiveness and subjectivism into the fabric of a variety of issues in economics, showing the analytical usefulness of the Austrian concepts of time, uncertainty, profits, disequilibrium, and the market process. What emerges is a wholly consistent and open-ended research program that provides an alternative to those dissatisfied with "textbook economics".

Professor Garrison in his paper on "intertemporal coordination" presents a more specific case for the usefulness of the Austrian research program as an alternative to textbook macro-economics, and in particular draws attention to the hazards of excessive aggregation. Theoretical models that obscure the heterogeneity of capital in general, and the diversity of capital goods with respect to the time structure of production in particular, conceal a key aspect of the market's coordination process. Garrison argues that in contemporary macro models the adequacy of the market process to allocate resources over time "is problematic to non-existent". The use of economy-wide aggregates is at the expense of a deeper analysis of

(continued on page 4)

"Muster-Voraussagen" und "Erklärungen des Prinzips" bei F.A. von Hayek: Eine Methodologische Analyse

by Hans-Georg Graf, Tübingen: J.C.B. Mohr, 1978, 108 pp., DM 19.80.

Reviewed by Stephan B. Böhm

Professor Hayek's keen interest in problems of the philosophy of science in general and the methodology of the social sciences in particular accounts for a considerable portion of his impressive *oeuvre* and can be traced to his celebrated 1937 paper "Economics and Knowledge", which with its far-reaching methodological implications can justly be regarded as a turning point in his illustrious career.

Hayek's insistence on and defense of the subjective and individualist approach of the social sciences was the central theme of "Scientism and the Study of Society" (reprinted in his *The Counter-Revolution of Science*, 1952) and sparked off one of the liveliest debates to have graced the philosophy of social science, the now-classic controversy of the 1950s over the issue of methodological individualism versus holism (collectivism). It is hardly surprising that Hayek's plea for a methodological dualism went unnoticed by economists at a time when Milton Friedman's most influential 1953 essay imported allegedly Popperian "positivist" philosophy of science into economics.

Hayek has subsequently elaborated his ideas on the methodology of the social sciences in a number of significant papers, "Degrees of Explanation" (1955) and "The Theory of Complex Phenomena" (1964) being perhaps the most important among them. Although interest in Hayek's social and political philosophy seems to be a growth industry (e.g. Norman Barry, *Hayek's Social and Economic Philosophy*, London: Macmillan 1979), his more recent contributions to the methodology of social science, beautifully summarized in his Nobel Memorial Lecture "The Pretense of Knowledge", have hardly received any serious attention from philosophers, let alone economists. Austrians cannot be completely absolved from this charge.

In view of these circumstances, Hans-Georg Graf's methodological study of Hayek's "pattern predictions" and "explanations of the principle" is a most welcome and long overdue addition to the literature. The introductory chapter, "The Principle of the Unity of Method and the Peculiarities of the Subject-Matter of Economics" briefly discusses some of the recurrent themes sounded by Hayek ever since the publication of "Scientism and the Study of

Society": his vigorous attack on "scientism", "the slavish imitation of the method and language" of the natural sciences by the social sciences. In contrast Hayek conceives of the social sciences as sharply distinguished by (1) their essentially *subjective* character, not only in the sense that opinions, beliefs, and attitudes constitute their object, but also in that the method of obtaining knowledge of these "facts" is subjective, (2) their "compositive" or "synthetic" method (*methodological individualism*), and (3) the enormous *complexity* of their subject-matter.

Chapter two, "A Closer Look at the Methodological Problem of Complexity," provides a perceptive account of the Austrian notion of the market process, drawing heavily upon arguments Hayek employs in "Competition as a Discovery Procedure" (1968), and the Kirznerian treatment of the market process in *Competition and Entrepreneurship*.

In the third and final chapter, "The Methodology of Explanation and Prediction in Dealing with Complex Subject-Matters", covering half of the book, the author seeks to shed light on the logical structure and epistemological status of Hayek's "pattern predictions" and "explanations of the principle", relating them to the familiar Hempel/Oppenheim covering-law model of scientific explanation.

Many reasons have been offered, not least by Hayek himself, for supposing that the social sciences require different kinds of method and justification from the natural sciences, and conversely for supposing that these methods and justifications are or ought to be the same. In Hayek's case, it is by no means always so clear that the sharp distinction he claims to obtain between the natural and social sciences is a distinction in *methodology*, i.e. the logic of justification, as opposed to methods, i.e. techniques of investigation.

As the author points out on p. 8, he appreciates Hayek's theory of complex phenomena as a modification of rather than as a radical departure from the methodology of the natural sciences. For Graf, the emphasis on the aspect of complexity of social phenomena in Hayek's more recent writings does not replace the subjective and compositive method stressed in his earlier work; it rather supplements it. The doctrine of methodological individualism, i.e. the explanation of social processes in

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Briefs

The Winter 1980 issue of *History of Political Economy* (Vol. 12, #4) contains an article by Professor Gerald P. O'Driscoll entitled "Frank A. Fetter and 'Austrian' Business Cycle Theory." The article shows how Fetter's theory of capital and interest led him to develop a theory of business cycles which was quite similar to the theory that was later expounded by Mises and Hayek.

R.R. Nelson's "Assessing Private Enterprise: An Exegesis of Tangled Doctrine," which appeared in the *Bell Journal of Economics* (Spring 1981) is an important attempt to reexamine the question of market performance in light of many of the contributions of Mises and Hayek. Nelson contrasts the standard neo-classical idea of efficiency with Hayek's perspective which emphasizes the ability of institutions to disseminate knowledge.

Sudha Shenoy has edited a recent monograph put out by The Society for Austrian Economics in conjunction with the David Hume Society entitled *Order Without Design: Three Conference Papers on Economic Models and Social Formations*. Contained within are three essays: Antony Flew's "Intended Action and Unintended Consequences", Naomi Maldofsky's "Market Theory: Which One?", and Sudha Shenoy's "From Walras to Menger: General Equilibrium and its Microfoundations — An Austrian Commentary."

Norman P. Barry's "Austrian Economists on Money and Society" (*National Westminster Bank Quarterly Review*, May 1981) provides a helpful explanation of Austrian monetary theory which shows that it is fundamentally different from and at least in some respects superior to both the Chicago and Keynesian approaches to macroeconomics.

A Conference on "The Contributions of Ludwig von Mises to Economics" was held in New York from September 20-22 in honor of the 100th Anniversary of Mises' birth. Sponsored by New York University and Liberty Fund, the conference included papers by James Buchanan, Israel Kirzner, Steve Littlechild, Brian Loasby, Mario Rizzo, Leland Yeager, and Gerald O'Driscoll.

The A.E.A. Session (continued)



Roger Garrison

certain critical market processes involving the intertemporal coordination of economic activity. The development and evolution of the crucial concept of time and its role in the structure of capital is traced from Bohm-Bawerk through Wicksell and others to the dominant macro models of today. The Austrians, Garrison contends, are in a unique position to grapple with the problem of intertemporal coordination precisely because of the tradition's fundamental emphasis on the market process conceived as a decentralized procedure for coordinating the heterogeneous components of the capital structure into a coherent network of production. Treating capital as a simple quantity, K, does not take us very far in explaining the complex coordination through time that continually takes place within the capital structure.

In the third paper Professor McCulloch, drawing on Ludwig von Mises' discussion of how monetary disturbances affect the price level, constructs a mathematical model of the inflationary process under the guise of a moderate quantity theory. The attempt is to develop "a new and somewhat different partial adjustment equation" using microeconomic considerations, although members of the audience may have wondered whether some of Garrison's warnings about the pitfalls of overly simplified macro models could be directed at McCulloch's model as well.

The commentators' remarks and the brief discussion that followed the three papers were both interesting and quite revealing. The chair, breaking from standard practice, acknowledged the presence of the distinguished scholar, Lord Lionel Robbins, for comment. Professor Robbins, somewhat startled from the attention, was sympathetic with the main theme of the O'Driscoll/Rizzo paper and

"Muster-Voraussagen" und "Erklärungen des Prinzips" (continued)

terms of individual actions, attitudes, and beliefs remains the basis of the theory of complex phenomena. This point deserves special attention because a careless reading of Hayek's "explanatory patterns" might lend itself to a holistic interpretation. Moreover, pattern models of explanation of the holistic type, as expounded in the writings of A. Kaplan and P. Diesing, form the methodological basis of institutional economics. In this connection, it is worth mentioning that the late Jacob Viner, among others, has raised the charge of "historicism" and "social Darwinism" against Hayek in his review of *The Constitution of Liberty* (*Southern Economic Journal*, 1961).

Figuring prominently on the list of criticisms leveled at the possibility of a social science, the notion of "complexity" has troubled social scientists, and especially economists, for some time. However vague and ambiguous the term may be, it is fairly safe to argue that, in a very broad meaning, it encapsulates all those problems which are held to face the establishment and development of a theoretical social science. More specifically, ever since J.S. Mill's discussion of the moral sciences in *A System of Logic* it has been maintained that the relevant factors in social scientific studies are far too numerous ("plurality of causes") to be ascertained and too rapidly in flux to provide the necessary stable conditions for the separation of causes from contingently accompanying factors. A radical conclusion from these points, which has frequently been drawn, would be the assertion that all phenomena of the social world must be considered unique, thus precluding any satisfactory empirical generalisations.

reiterated that Austrians should not be "too exclusive". He was concerned that the Austrian school "tends to disassociate" itself from the rest of the profession even though "there is a lot going on in modern theory today and a lot that deserves to be taken notice of."

But the exclusion that has kept Austrians and other modern economists from fruitful interaction has not been *entirely* the fault of the former disassociating themselves from the latter. In any case, as this session of the A.E.A. eloquently testifies, the modern Austrian school does not see itself as a wholesale rejection of contemporary economics but rather a positive program for its further development.

In "Degrees of Explanation" Hayek argues that in the construction and application of explanatory patterns for typical complex situations we are essentially performing a deductive task, which does not provide us with new knowledge. "What will be new about such a 'new' explanation of some phenomena will be the particular combination of theoretical statements with statements about facts regarded as significant for the particular situation (the "initial" and "marginal conditions"), not any one of the theoretical statements from which it starts. And the problem will not be whether the model as such is true, but whether it is applicable to (or true of) the phenomena it is meant to explain." (Hayek, *Studies*, p. 7)

The assertion that a certain explanatory pattern (or model) is applicable is an empirical, and hence falsifiable statement; in this case, "applicability" refers to the phenomenon to be explained rather than to a subsumption of concrete initial conditions to the abstract conditions contained in the if-component of a nomological statement.

On the other hand, Hayek has forcefully insisted on the possibility and indispensability of "abstract" social theory. As Graf notes on p. 46, Hayek sets out to find a solution to the following problem: Given the social scientist's ignorance of the circumstances determining specific outcomes, how is it possible in the disciplines dealing with structures of essential complexity to establish empirical theories which do take the causality of the individually known facts somehow into account instead of assuming them away and relegating them to unspecified *ceteris paribus* conditions? Hayek proposes that instead of aiming at explanations and predictions of individual events, which would require unattainable knowledge of singular circumstances, we should content ourselves with less specific *explananda*, thereby reducing the information required in the *explanans*. "Explanations of the principle" and pattern predictions do not refer to particular events but always to *some* properties of a particular phenomenon.

The far-reaching implications of this position for interventionist policies are obvious. Under the formidable aegis of Erich Hoppmann of the University of Freiberg, the translator of *Competition and Entrepreneurship*, these Hayekian arguments have had a great impact on discussions of antitrust policy in the West German literature.

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"Muster-Voraussagen" und "Erklärungen des Prinzips"

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In "The Theory of Complex Phenomena" Hayek takes pains to point out that "predictions of a pattern are nevertheless both testable and valuable. Since the theory tells us under which general conditions a pattern of this sort will form itself, it will enable us to create such conditions and to observe whether a pattern of the kind predicted will appear." (F.A. Hayek, *Studies in Philosophy, Politics and Economics*, p. 36)

This quotation seems to suggest very clearly that Hayek's "pattern predictions" are statements in the logical form of a universal conditional, or in other words, the general "if-then" statement is subject to falsification, and not only the singular statement that a particular pattern will occur. According to this interpretation, "pattern predictions" and "explanations of the principle" are based on a system of nomological hypotheses about the occurrence of abstract patterns.

Graf argues (p. 84) that the examples which Hayek offers as candidates for potential falsifications of his pattern predictions are misconceived because they merely negate the if-component of the universal conditional, which simply means that the statement is not applicable to this specific example. The author proceeds to demonstrate that Hayek himself has come up with a rather different interpretation of the logical structure of his "explanations of the principle".

To be sure, many questions will still trouble students of Hayek's theory of complex phenomena after having read Graf's essay. Nevertheless, the author is to be congratulated on his admirable job of clarification of a somewhat mysterious, hitherto sadly neglected aspect of Professor Hayek's work. He credits Hayek with having designed a systematic methodology which enables us to do theoretical work in the face of the seemingly insurmountable problems posed by the complexity of social phenomena, contrary to those critics of "scientism" who simply argue that "social science is not 'really' possible." Moreover, Graf succeeds in demonstrating that Hayek's notion of complexity is intimately linked to his familiar notion of competition as a discovery procedure. Substantive and methodological issues cannot be separated in Hayek's theory of complex phenomena. And that is precisely why, in the reviewer's opinion, Hayek's theory is so much superior to the shallow trivialities that many economists—with the notable exceptions of Brian Loasby and Herbert Simon—have written on the subject of complexity.

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A Tiger by the Tail: The Keynesian Legacy of Inflation

by F.A. Hayek, compiled and introduced by Sudha R. Shenoy;

San Francisco: Cato Institute, 1979, 176 pp. \$4.00.

Reviewed by Robert L. Bradley, Jr.

Over the past five decades, F. A. Hayek has been a notable yet relatively neglected participant in the debates of greatest concern to professional economists and laypersons alike—unemployment, inflation, and the trade cycle. In an expanded reprint recently published, pertinent excerpts from Professor Hayek's writings over this period are collected that in sum constitute a systematic critique of what is called "the Keynesian Legacy of Inflation." Entitled *A Tiger By the Tail*, Hayek focuses on the theoretical case for and consequences of expansionary monetary policy, a policy popularized by J.M. Keynes' *General Theory of Employment, Interest, and Money* of 1936.

Historians of thought will remember that in the early thirties, Hayek and Keynes - and their respective students - carried on theoretical debates in the journals of economics. (An account of this rivalry is provided in J.R. Hicks' "The Hayek Story" in *Essays in Monetary Theory*.) The debate, however, was prematurely ended when Keynes' above work became so methodologically and politically in favor that a non-theoretical victory was achieved over Hayek. The "Revolution" was so complete, in fact, that a discouraged Hayek left economics for social and political philosophy. But with the recent reconsideration of Keynesian theory, in light of the problems Hayek had originally warned against, the once closed debate is reopened with Hayek's contributions as pertinent as ever.

The book under review is distinguished in two different but highly related senses — one methodological and one analytical. After first examining Hayek's methodological positions, we will apply these to his specific criticisms of Keynes' case for expansionary monetary policy.

I. Hayek on Methodology

Throughout all of Professor Hayek's writings - including the rich sampling contained in the present volume - four methodological parameters, explicitly or implicitly, are to be found.

1) Statistical averages and aggregates are inappropriate in economic reasoning since only within their micro components is causality present. As he states (p. 14): "...none of these [macro] magnitudes as such ever exerts an influence on the decisions of individuals; yet it is on the assumption of a knowledge of the decisions of individuals that... economic theory [is] based."

2) Statistical modeling and testing likewise cannot decide between competing theories since the macro correlations are more coincidental than causal. Hayek speaks (p. 104) of the "complex order of economic life" that for testing makes the necessary *ceteris paribus* postulate impossible to assume, unlike in the laboratory sciences.

3) Economic analysis must study an hypothesized economic situation in its entirety rather than emphasize short run developments only. Hayek recognizes (pp. 33-34) that "what is best in the short run may be extremely detrimental in the long run," and thus to leave the public uninformed regarding the latter would be a "dangerous intellectual error" and "betrayal of the main duty of the economist."

4) Economic analysis must methodologically (not empirically!) assume full employment to understand situations of less than full employment rather than beg the disequilibrium question. Keynes, contrarily, postulated, in Hayek's estimation (p. 101) "full unemployment: the assumption that there normally exist unused reserves of all factors and commodities" and is criticized since "this assumption—makes the whole price system redundant, undetermined, and unintelligible."

The above methodological statements are all antithetical to the Keynesian paradigm. The "model-test" method, suggested more than utilized by Keynes in *The General Theory*, has become the litmus test of theoretical inquiry for this school. Averages and aggregates, handmaidens to the "positivist" method, are assumed to be independent of the microeconomic interrelationships within them.

Further, Keynes' preoccupation was with the short run, indicated by his most famous quotation ("In the long run we are all dead") while his most remembered theoretical novelty was the alleged "escape" from the neo-classical full employment assumption. So all in all, we can appreciate the sharp divergences between Keynes and Hayek regarding method that brought forth the specific arguments we will review below.

II. Hayek on Keynes

Keynes' holistic thinking simplified an economy to the point that his "demand management" idea assumed plausibility. To him, the twin (and supposed-

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Unemployment and Monetary Policy: Government as Generator of the "Business Cycle"

by F.A. Hayek, San Francisco: Cato Institute, 1979, 80 pp., \$2.00.
Reviewed by J.A. Dorn

This reprint is an updated version of the IEA's *Full Employment at Any Price* revised for the American audience, including in this edition a new Preface by Hayek, a concise introductory note on Austrian Capital Theory by Sudha R. Shenoy and an excellent Forward by Gerald P. O'Driscoll, Jr. It is divided into three parts. Part I, "Inflation, Misdirection of Labor, and Unemployment," is a revision of a lecture Hayek delivered in Rome in February, 1975. Part II, "The Pretense of Knowledge," is a reprint of Hayek's 1974 Nobel Address, and Part III, "Unemployment: Inevitable Consequence of Inflation," is a revision of his Rome lecture delivered in the United States in April, 1975. The purpose of these lectures is to make us rethink the fallacies of the now-crumbling Keynesian orthodoxy in order to avoid repeating the same policy errors that have produced the current "stagflation."

In Part I Hayek presents his main policy message of the last 40 years—the impossibility of curing inflation without unemployment. By this Hayek does not mean we should use unemployment to fight inflation; he means that unemployment necessarily follows from inflation's effect on relative prices. The inflationary "full employment" policies followed since the end of World War II present us with three policy alternatives: Allow inflation to accelerate and ultimately destroy the market economy; impose wage-price controls and sabotage the indispensable guiding role of relative prices; or stop expansionist monetary policy altogether and accept the temporary increase in unemployment. Hayek, of course, favors the third alternative. His experience with the "Great Inflation" taught him that "the employment created by inflation diminished as soon as the inflation slowed down, and that the termination of the inflation always produced . . . a 'stabilization crisis,' with substantial unemployment" (p. 4). Consequently, Hayek has never been convinced by the Keynesian thesis that employment is determined by total spending.

Hayek offers two reasons why the Keynesian paradigm gained attention vis-a-vis his own theory, which stipulates a direct relationship between above-equilibrium wage rates and unemployment. First, Keynes' theory was statistically tested and found apparently consistent with the facts, while his own theory was "untestable" because equilibrium states are unknown *ex ante*. Hayek therefore contends that "scien-

tistic prejudice" led to the rejection of his "true" theory and the adoption of a "fatal idea": that the cause of unemployment is insufficient aggregate demand rather than a disequilibrium pattern of relative wages. The second reason Hayek gives is that since Keynes' policy prescriptions generate instant benefits, they offer broad political appeal compared to Hayek's call for immediate sacrifice. In Hayek's opinion this is a much stronger reason for the success of the "Keynesian Revolution" than its "scientific" appeal.

Not only does Hayek reject the notion of a permanent trade-off between inflation and unemployment, he sees inflation as ultimately increasing unemployment. In other words, he sees the possibility of an upward sloping Phillips curve in the absence of stabilizing expectations. His explanation is that as inflation accelerates it will introduce more and more distortions into the relative price structure. This "noise" renders the market communications system less useful as a means of efficiently allocating resources. Consequently, more labor and capital will be misdirected and unemployment rates will increase along with inflation. Indeed, empirical evidence has been consistent with this thesis: the inflation rate and unemployment have ratcheted upward in the U.S. over the last 30 years.

In Hayek's view, the most serious consequence of inflation is not the arbitrary redistribution of income, but the misallocation of resources. Indexing would not cure inflation nor would it alleviate its effect on the pattern of relative prices and production. Hayek therefore proposes two policy measures that he believes will generate prosperity without inflation. First, in a departure from his earlier work (e.g. *Prices and Production*) and one that would perplex many "Austrians," Hayek recommends the adoption of a monetary rule in order to stabilize the value of money. He desires a rapid stabilization, but recognizes that for technical reasons the deceleration in monetary growth will probably have to be gradual. Hayek's monetary rule (like Friedman's!) would limit the growth of money to the growth rate of real output. According to Hayek, this policy should be clearly announced in order to dampen inflationary expectations; however, he says, the rule should not be legally binding. We should emphasize that Hayek has not abandoned his affection for the gold standard, but thinks it is impractical in

today's atmosphere.

Hayek's second proposal is to reestablish competitive markets through long-run institutional reform. He emphasizes that unless we can reduce union monopoly power and other barriers to entry, unemployment will persist. In modern jargon, he wants to shift the long-run Phillips curve leftward, and reduce the "natural rate" of unemployment by making markets more efficient.

Part II is devoted to an attack on "scientism"—the application of the



Friedrich A. Hayek

methods of the physical sciences to the social sciences—and its contribution to the adoption of Keynesianism. Hayek seems to believe that economic theories are testable in Popper's sense of being refutable, but that they cannot be used to make the same type of predictions as most physical sciences. The best we can hope for is "pattern prediction," rather than prediction of specific numerical results. Nevertheless, many economists have been swayed by the "scientific attitude" to search for theories that produce numerical predictions.

A Tiger by the Tail (continued)

Keynesian theory filled this mold and gave rise to numerous forecasting models, while Hayek's did not.

Hayek is not opposed to the use of mathematics in economics. Pareto's equations, he points out, are very useful to illustrate general equilibrium and economic interdependence, but to think that they can actually be solved by plugging numbers into some computer model is absurd. Central planners simply do not have the relevant information that would be necessary to predict exact

ly opposite) evils of inflation and resource idleness were, in final analysis, an aggregate demand problem that monetary policy could control. (Hayek's interpretation of Keynes, one notices, downplays the other two levers of demand manipulation — government spending and taxing.) In the context of Keynes' 1936 work, despite the adjective *General*, expansionary monetary policy to combat economic depression was the focal point.

Against this, Hayek's view of "easy money," before and after Keynes restated the inflation argument "in an original and apparently much improved form (p. 127)," is that such policies would both create tendencies for unwanted upward price movements and distort the production structure away from underlying consumer preferences. Thus to Hayek, far from being a cure for unemployment, monetary expansion is the root cause of the problem.

Keynes' fundamental error, Hayek argues, was his belief that (p. 101) "the creation of additional money (would) lead to the creation of a corresponding amount of goods." Such an error logically followed the equally specious assumptions it was based upon—the full unemployment postulate as well as the non-microeconomic view of price changes and the capital structure. But once we admit to the (p. 27) "varying degrees of scarcity", as Hayek postulates, "bottlenecks" and the like allow inflationary pressures to develop within a situation of idle factor capacity. Thus, a rudimentary explanation of "stagflation" is provided. Further, the inherent shifts of relative prices due to the monetary increases employ and reemploy resources that create tensions of reversibility once the impermanent money creation is *anticipated* and/or *slowed*. (See pp. 60-61, 88-89 on this point.) Hayek's cycle theory, stemming from Wicksell and Mises, is elaborated in his other writings, notably *Prices and Production*.

Thus Hayek's analysis of Keynes' program for achieving and maintaining full employment emphasizes the microeconomics of prices and production that the macro method must preclude. But of equal importance is the understanding —also made possible from the micro-theoretic point of view—of the existence of "non-fictional" unemployment. To Hayek (p. 123), "the problem of unemployment is in the last resort a wage (read price) problem," not an inadequacy of aggregate demand. The

cure, then, is to have wages and prices, sectorally, be at market clearing levels. This would translate into lowering wages and prices in surplus situations and *not* as Keynes recommended, depreciating real wages via monetary creation. In this regard, a free market in labor—a "true freedom of association" (p. 78)—is the recommended institutional framework.

III. Hayek on the Future of the Debate

The close interrelationship between the methodological and analytical in his censure of Keynes is fully recognized by Hayek. His dissatisfaction with Keynes' *General Theory* stemmed from (p. 98) "the general (macro) approach followed in the whole work" and not "so much to any detail of analysis." And he believes that his fellow economists will also choose sides on the "Hayek-Keynes" debate because of method rather than detail. As Hayek concludes (pp. 103-104):

I believe (my debate with Keynes) will be decided not by any future discussions of his special theorems but rather by the future development of views on the appropriate method of the social sciences...I venture to predict that once this problem of method is settled, the "Keynesian Revolution" will appear as an episode during which erroneous concepts of the appropriate scientific method led to the temporary obliteration of many important (read microeconomic) insights which we had already achieved and which we shall then have painfully to regain.

In all, *A Tiger By the Tail* offers the reader a wide ranging review of Keynes' ideas by his then and now principal rival, F.A. Hayek. And since Hicks and others steeped in the Keynesian tradition have tried to emphasize to the profession this rivalry and the need to understand Keynes through understanding Hayek, the book under review should be of great service.

Note To The Reader:

We, the editors and staff of AEN, sincerely apologize for the fact that the printing of this issue has been delayed for so long. Due to circumstances beyond anyone's control, however, this delay was unavoidable.

It is our intention to once again get each issue to you on schedule and, of course, to continue in our efforts to provide a useful forum for the communication of Austrian ideas.

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outcomes in a complex system like the market. This has been one of Hayek's main points during his long career (see "Economics and Knowledge" in *Individualism and Economic Order*). Hayek therefore warns us to be "humble" in our expectations concerning the usefulness of mathematics in economics. We should not be embarrassed by our inability to predict specific outcomes: pattern predictions are useful and can help us avoid costly policy errors.

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Unemployment and Monetary Policy (continued)

In Part III Hayek repeats many of the ideas covered in Part I; one important addition, however, is his discussion of "secondary depression." We can list two causes of a secondary depression. (1) Institutional rigidities such as union power and minimum wages could force real wage rates above their market-clearing levels, causing localized unemployment. This would induce a cumulative process—the secondary depression—in which unemployment would feed on itself. In this case, Hayek would not call for monetary expansion but would recommend institutional changes to correct the relative price structure. (2) A decrease in the money supply, initiated by the monetary authorities or by real factors, leads to a distortion in the structure of relative prices, profits and production. The process of deflation, however, is cumulative: as investment projects are terminated there is a reduction in the flow of money income at that point, which then spreads in all directions to further reduce employment. In this case Hayek recommends the "appropriate monetary countermeasures" (p. 40).

Hayek makes several other important points in Part III. (a) During a period of "prosperity," brought about by an excessive increase in the money supply, it is very difficult to discover the misdirected resources except through the market mechanism. Moreover, the only permanent way to increase employment and raise the standard of living is to increase labor productivity via capital accumulation. Every recovery must begin with the restoration of profitable investment. (b) Hayek thinks the quantity theory is a useful pedagogic device for the general public, but stresses the need to go beyond the mechanical relationship between money and prices. In particular, we should examine the transmission process initiated by the monetary disturbance and ask why the money supply normally increases faster than real output. (c) Finally, Hayek reiterates his main theme by way of analogy. He likens the "choice" between inflation and unemployment to the "choice" between overeating and indigestion.

In conclusion, this pamphlet is a useful introduction to Hayek's methodology and his theory of unemployment and the business cycle. The serious reader, however, will want to pursue these ideas further. A good place to start is the recommended reading list at the end of the pamphlet.

The Keynesian Episode: Yeager (continued)

in other sectors also.

Since wrong prices are what frustrate exchanges and impair production, Hutt does not blame any inadequacy of "spending". Instead of determining the volume of exchanges, spending gets determined: the flow of money changing hands in lubricating transactions depends on the physical volume of transactions and on the level of money prices at which this real flow is measured in nominal terms. Economists went wrong when, under Keynesian influence, they "came to regard income as created by transfers of money instead of as provided in the form of a flow of productive services *measured* in money" (p. 90). "... it is fallacious to suppose that *expenditure* either produces real income or the money valuation of income (determined by the value of the money unit), but . . . , on the contrary, it is the value of the money unit which determines how much expenditure is necessary in order to acquire a given *quantum* of services or assets" (p. 381). This is not to say that monetary disorder never plays any role in frustrating exchanges and production. It does. Even then, however, wrong pricing must be involved. (More about this comes later.)

Hutt modestly claims little originality for his doctrine. He claims to be just expounding and perhaps amplifying what classical and neoclassical economists had been saying and, in particular, what he learned at the London School of Economics after World War I. Hutt's doctrine obviously is not Austrianism. He makes less use than the Austrians of the distinctions between consumer and capital goods and among capital goods of different orders. He propounds nothing closely resembling the Mises-Hayek theory of the business cycle. His diagnosis of macroeconomic disorder is less specific: interferences with setting prices at which markets would clear are disrupting economic coordination. In the realm of policy, Hutt envisages a more activist government than the Austrians do, particularly in thwarting the just-mentioned interferences. With reservations, he advocates a policy of trying to stabilize the purchasing power of money. Yet he has much in common with the Austrians, including an appreciation of general economic interdependence, of the problem of coordination, and of the significance of complementarities among capital goods; a concern with actual processes and with the decisions and actions of individual persons; an understanding of why effective use of dispersed knowledge requires

decentralized planning, and an appreciation of the role of entrepreneurs.

Hutt touches on certain crucial questions, but without being explicit enough in answering them. Just what is the role of money in economic coordination and discoordination? In some passages Hutt is at such pains to penetrate behind the veil of money that he practically denies money's routine but momentarily important function as the medium of exchange; he actually says that people are buying goods and services with money only when, untypically, they are acting to reduce their cash balances. When inflation appears to be stimulating a depressed economy—a phenomenon beloved of the Keynesians but not of Hutt—does the stimulus come from the monetary expansion as such, with prices lagging and the quantity of money thus growing in real terms, or from the price inflation itself, which may be rectifying wrong relative prices (for example, by eroding excessively high real wage rates)? In a malcoordinated and depressed economy, does the trouble necessarily stem from wrong relative prices (such as excessive real wage rates) or might it stem instead mainly from prices and wages that, although not badly out of line with each other, are *generally* too high (or conceivably too low) in relation to the nominal quantity of money? In some passages Hutt emphasizes *unstable* price rigidities and people's postponement of purchases in order to hold money while waiting for the rigidities to break down and prices to fall; he seems to imply that the particular price level would not matter if its *permanent* rigidity were obviating the just-mentioned expectations and postponements. In other passages he advocates a policy of flexibly accommodating the nominal quantity of money to the existing price level, as if he were indeed concerned about the painful necessity of otherwise adjusting the price and wage level to the money supply.

If Hutt were cross-examined on these and other issues, he would, I imagine, give what I consider the right answers to most of them. However, his failure to make his meaning clear in the first place prompts me to make some observations on his writing style. (I regret seeming to criticize Hutt. His message is important and largely correct—far more so than the Keynesianism that until recently was so dominant in scholarship and policy. His article "The Yield from

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The Keynesian Episode: Yeager (continued)

Money Held", first published in the Mises Festschrift of 1956, is in my opinion absolutely fundamental to monetary theory. Not the least of his admirable personal qualities is his indefatigability in pursuing impressive scholarship even at the age of 81. However, a book review is not supposed to stop short with a summary; it is supposed to go on to an assessment.)

In the present book and earlier ones, Hutt has complained about how little serious attention his writings have commanded and how little substantive scholarly dialogue he has been able to elicit from economists under Keynesian influence. Those of us who are sympathetic to his message can learn from his frustrations.

For two reasons I myself have been turned off by Hutt's style less than most readers probably would be. First, when I came across Hutt's writing decades ago, I happened to be predisposed in favor of the sort of message he was trying to convey. Second, and perhaps more important, I was privileged in or around 1955 to attend a two-week conference at which Hutt was one of the main speakers (along with Ludwig von Mises). Later, when he served as Visiting Professor at the University of Virginia, we were colleagues. His analytical message, his humanitarian concern for those suffering from restrictions on economic opportunity, his intellectual force and zeal, and his integrity come across better when he has ample opportunity to present his message in person than when he offers it in print alone. I am not surprised that readers who lack my advantages in approaching his work may react with bafflement or even hostility.

There seems to be a trend in economics toward insisting that everyone be either presenting a "model" or "testing" one. "What is your model?" is the insistent cry. Well, Hutt's style is so much at the opposite pole that a preference for model-mongering would be understandable if one had to choose between the two extremes. Hutt's exposition is a collection of discursive and often cryptic remarks. Strewn over hundreds of pages, and in no readily intelligible order, we find bits of positive analysis, bits of criticism of Keynesianism, historical allusions, and policy proposals. Hutt has a habit of latching onto remarks by other writers as they are apparently cast up at random by his own

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The Keynesian Episode: Egger (continued)

Episode's message is that "macro-economic" problems of unemployment and declining output result from improper relative prices, not from insufficient consumption or an improper general price level, and that various theoretical misunderstandings prevent the Keynesian outlook from realizing this. Most important—and the topic of another Hutt book—is Say's Law, by which Hutt means that the supplying of a good or service contributes to the source of demands for noncompeting goods or services. Although this idea appears frequently in the book, it is worded a little differently each time. In his new chapter on pre-Keynesian weaknesses, for example, Hutt states that many economists "did not realize the extent to which each individual pricing of an input or output above the market-clearing level is depleting the source of demands for noncompeting inputs or outputs." (p. 58) On page 160, he writes: "Say's Law (in the broad sense of the principle that the demand for any commodity is a function of the supply of noncompeting commodities). . . . Misunderstanding and excessive aggregation, Hutt argues, thwart the Keynesians' recognition of this truth, while the desire for political acceptability (he writes of "the buying off of antisocial pricing" through "the policy of maintaining 'effective demand'" (p. 129)) further motivates the ignoring of Say's Law insights.

The focus on Say's Law highlights Professor Hutt's emphasis on coordination via the price system. A higher wage demand by plumbers, for instance, may increase our demand for pipe wrenches, sponges, and "how to fix your own toilet" books, but it will *reduce* our demands for goods which (unlike these things) don't compete with plumbers' services. In principle, given time, a new set of relative prices will emerge consistent with "full employment," but new skills will have to be learned and different wages accepted. Professor Hutt joins Lionel Robbins and F.A. Hayek, among others, in observing that expansionary monetary policy may be a politically attractive means of concealing or postponing the real adjustments which are required—"buying off antisocial pricing."

The Keynesian Episode is more anti-union than its 1963 predecessor. Professor Hutt's position is best presented in his *The Strike-Threat System* (1973); he believes unions can provide useful information which benefits both employer and employee, and would not wish them outlawed. He does, however, favor the

outlawing of strikes and strike-threats (see p. 133 of *Episode*, for example).

The chapter "The Nature of Money" reveals a much-expanded role (since 1963) for the "identity" of exchange $MV = PT$, permutations of which pop up frequently throughout the book. Although he occasionally writes things like "the inflationary part of the expansion of money income can be defined as that part of the increase in MV which is not accompanied by an equivalent increase in T " (p. 129), his real insights are much more subtle: changes in V should not be said to *cause* changes in P , for example: *both* are caused by a change in individuals' valuations of money. Hutt criticizes the claim that Keynes integrated monetary and value theory, pointing out that in fact pre-Keynesians had long since accomplished this. (Whatever one may think of Adam Smith's value theory, he clearly applied it to money; while Mises (1911) first successfully integrated money with modern subjective value theory, he was by no means the first either to emphasize the importance of—or to achieve—integration of monetary theory with whatever value theory was dominant at the time.) What Keynes did was attribute "to monetary and fiscal policy coordinative functions which are normally performed in a quite different way" (p. 187)—presumably through relative-price adjustments.

Professor Hutt's monetary policy is basically "stable price index." In three new pages at the start of this chapter, he proposes a bifurcate policy: Congress is to specify the rate of change of the price index, while the central bank is to effect this goal. Strangely, Hutt, like Wicksell, fails to follow through with his own reasoning: he uses the term "natural rate" as the non-inflationary rate of interest and discusses briefly the time structure of capital, yet fails to realize that the creation or destruction of nominal money required to preserve the level of prices will necessarily cause relative-price distortions and attendant resource misallocation. With the real excitement nowadays revolving around competing, privately-produced monies, it reflects Hutt's conservatism that he still seeks reform which would harness the government monopoly for the public good.

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The Keynesian Episode: Egger (continued)

Professor Hutt prefers not to be classified into any "school," although Austrians will applaud many of his arguments. The whole volume is an impressive restatement of the "coordination" view of macroeconomic issues (and so, it is important to realize, was its 1963 ancestor). More specifically, he comes down hard on Keynes's mixing and blending of time preference and liquidity preference, arguing forcefully that the one has no logical relation to the other and, in particular, that liquidity preference (the demand for money balances) has nothing to do with interest. Although this alone does not make Hutt a "pure time-preference" interest theorist (a la Fetter, Mises, and Rothbard), several passages suggest his sympathy with such a view (pp. 306-7, for example). Few such theorists, however, would agree with his interpretation (pp. 331-2) that what the existence of perishable goods may produce is properly termed a negative interest rate.

Hutt cites Keynes's "user cost" as "the most original and useful concept which Keynes introduced," (p. 418 n.), referring to the subjective-cost Appendix in *The General Theory* which Professor Lachmann has repeatedly identified as Austrian in character. His "The Nature of Consumption and Saving" (Chapter 13) takes a delightfully "essentialist" approach in which consumption is, following J.B. Say, "the extermination of value" and has nothing to do with spending money. "Consumption demand" appears a rather silly phrase in this view, referring—albeit misleadingly—to replacement in one's portfolio of some asset (e.g., a can of beans) which he has consumed (literally, I guess, in this case). When one consumes an asset, his ability to demand *other* goods by offering it in trade evaporates. Whatever it may do to the *desire*, consumption reduces the *ability* to demand. He introduces Bohm-Bawerkian capital theory as a necessary part of his saving-and-investment discussion (p. 292), and refuses to force these concepts into the traditional households-and-firms classification. While his brief (pp. 99-103) Appendix, "The Limitations of Mathematical Method in Economics," is principally a harsh criticism of the overwhelmingly pervasive scientific silliness afflicting the profession ("Where's your model?"), Hutt seems aware that the use of symbolism and mathematical technique may occasionally aid in the solution of logical puzzles.

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The Keynesian Episode: Yeager (continued)

reading, even if those writers are not leading or typical controversialists on the points at issue, and then using their remarks as pegs onto which to string observations of his own. This habit gives his exposition an unnecessarily polemical tone. The jumble of analysis and polemics includes observations about Keynes's slipshod and unoriginal theorizing and about his unfairness in scholarly controversy, as well as observations about Keynes's forceful personality and conjectures about the popularity of Keynesianism in the academic world and on the political scene.

Hutt scorns the fundamentalist Keynesianism that broods about adequacy or inadequacy of demand, about the propensity to consume out of real income, and about a saving gap that grows with income and wealth and so supposedly becomes all the harder to plug up with real investment spending, especially as real capital formation leaves fewer and fewer outlets available for still further investment. Saving, as such, cannot pose a problem. People cannot save without acquiring some assets or other. If this process, together with the associated financial transactions, results in real capital formation, well and good; opportunities for further investment still are not foreclosed. Complementarities exist among capital goods; having more of some makes it advantageous to create more of others. More fundamentally, perhaps, employing additional real capital in some sectors of the economy tends to raise productivity and real incomes there, which constitute additional demands for the outputs of other sectors and for the means of producing them. In short, saving devoted to capital formation and income growth in no way subverts the operation of Say's Law. If, on the other hand, savers neither acquire real assets themselves nor transfer their command over resources to entrepreneurs who will construct assets, then they must be trying to build up their holdings of money. Yet Keynes, says Hutt, tried to put the blame on an excessive propensity to save as such, obscuring the liquidity-preference or demand-for-money aspect of the disequilibrium. (This charge, it seems to me, overlooks chapter 17 of the *General Theory*. What Keynes might better be charged with is a lack of consistency among different parts of his book.) Actually, says Hutt (p. 295), "saving preference and liquidity preference are as unrelated as demands for monocles and bubble gum." Diagnosticians of depression should keep this distinction clearly

in mind. Even when an intensification of demands for money balances is contributing to macroeconomic disequilibrium, the blame should fall not on this particular change in preferences as such but on the failure of prices to adjust to it. In the face of insufficiently flexible prices, *any* change in technology or resources or preferences, including not only an intensification but even a weakening of savings preference or of liquidity preference, can impede market-clearing, exchanges, and production. The diagnosis must thus focus on how well or poorly the pricing process is working, and why.

Nowhere does Hutt precede his criticism with a systematic exposition of the Keynesian system; nowhere does he follow Karl Popper's healthy precept about trying to refute erroneous ideas in their soundest possible versions. In some places, as in criticizing multiplier theory, Hutt interprets Keynesian propositions in an unnecessarily unsympathetic way, which gives his own comments the character of blowing down straw men. How effective a controversialist against actual Keynesianism would someone be who relied on Hutt's presentation and criticism?

Strewed about among Hutt's other passages are echoes of obsessions that have long preoccupied him. He seems unwilling to recognize, for example, that the absence of sufficient price and wage flexibility to keep markets always clearing even in the face of severe jolts, such as monetary jolts, is practically inevitable and that theory and policy should take account of this inflexibility (along with other hard facts of reality). No; he blames price and wage inflexibility on villainy. An activist government has the duty of thwarting and punishing the villains, prominent among whom are labor unions. Even for me, no great admirer of unions, the repeated fulminations against them become downright boring. Some of the space so used might better have been devoted to evidence bearing on how quantitatively important unions are relative to other factors that also contribute to macroeconomic disorder. Hutt might well have considered whether unions are less (or more) important in these respects in the United States than in Great Britain (often he seems to have British conditions at the back of his mind). Another obsession carried over from Hutt's earlier books concerns Britain's return to the gold standard in 1925 at the prewar parity, requiring in-

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The Keynesian Episode: Yeager (continued)

ternal deflation if that parity were to remain workable. Repeatedly, though often in cryptic language, Hutt offers apologetics for that policy. He may even be right, but the way those apologetics keep intruding in unlikely places is characteristic of Hutt's style.

Another characteristic is his propensity to write in special terminology of his own invention and to brood at length over the meanings of terms and concepts. (Mercifully, Hutt's terminological eccentricities are somewhat less obtrusive in the present book than in earlier ones; perhaps he has taken some heed of criticism.) Hutt uses one term so much that I, anyway, have become accustomed to it: "withheld capacity". This term conveys the suggestion that people who, in ordinary language, are meeting frustration in finding customers for their products or in finding jobs are in fact *withholding* their capacity to produce or to work by insisting on prices or wages above the market-clearing level. So doing, they are withholding their demands for the goods and services of other people. This terminological allusion to villainy serves to shunt aside economic analysis of the nature of and reasons for price and wage inflexibility, including insights into how the interdependence of wages and prices narrows the reasonable options available to individual price-setters and wage-negotiators. Behind the veil of terminology, Hutt can damn reality for being real.

His special terminology would permit Hutt, if pressed, to defend propositions that are startling on their face. "The withholding of capacity which is capable of providing currently valuable services is always a case of restraint on freedom. . ." (p. 371n.) "... the labor of all able-bodied persons was demanded throughout the depression years. *It was not supplied*" (p. 169). "... consumption is always the *extermination* of power to demand. The failure of the Keynesians to understand this simple truth lies at the root of what I believe to be the most outrageous intellectual error of this age" (p. 341).

Hutt frequently covers himself against challenge by qualifying apparently egregious propositions with cryptic phrases that are hardly understandable unless one is already familiar with his terminology and his allusions. For example, "It is quite wrong to assume that unfavorable prospects can deter net accumulation, otherwise than through the discouragement of saving preference, or—indirectly—through the encouragement of the withholding of capacity (although

The Keynesian Episode: Egger (continued)

Nonetheless, all is not peaches and cream. Even an improved-readability version of *Keynesianism* has its difficulties. While after a half-dozen slightly different exposition of it one begins to think he has the idea, Hutt's interpretation of Say's Law may well leave the reader uneasy. If it said "the supply of one good is the demand for another," it would at least be interpretable in a precise fashion. But when "is" is replaced by the more rubbery "contributes to," and when—in addition—"demand" becomes "the source of demand," the reader is burdened with wondering in what circumstances these substitutions may be important. At four or five points Professor Hutt uses his term "money's worth"—a phrase found in *The Wealth*

such prospects certainly do influence *the form* taken by accumulation)" (p. 349). A similar habit is to mention government policies not straightforwardly but rather with reference to the results that Hutt would expect them to have. Thus, in a historical context: "... not a single governmental step toward multiplying the wages flow was taken" (italicized, p. 61), meaning, approximately, that the government did not engage in union-busting. (If I have got his meaning only approximately correct, well, Hutt should have straightforwardly said what he does mean.)

Because of its style, I do not expect Hutt's book to accomplish much toward converting the Keynesians. If they lack the background and the will to make the effort necessary to understand his eccentrically phrased message, they may even come away from his book fortified in their belief that he and their other critics are in the wrong. Whether he realizes it or not, Hutt is preaching to the already saved. Doing so, however, is far from pointless. Sympathetic readers can find much in Hutt's book to fortify their understanding of how the real world works and could be made to work better and much to deepen their insights into the fallacies of macroeconomic doctrines whose recent dominance has still not entirely been overcome. Teachers willing and able to give a sympathetic exposition of Hutt's book can make good use of it in their classes. It may well serve as the focus of stimulating and enlightening controversy in seminars and discussion groups that contain sympathetic readers. Hutt's latest book is another milestone in a long and distinguished career of indefatigable scholarship and humanitarian concern.

of *Nations* and used often in Hutt's 1974 *The Rehabilitation of Say's Law*—without definition; he considers it a Say's Law insight that "we buy with 'money's worth' and not with money unless we are reducing our inventories of money." (p. 238). Surely it's nice to be able to understand that there is a sense in which an agent in a money economy pays for his purchases with the services which yield his income, differences in their money values implying changes in his money balances, but does the term "money's worth" add to this understanding? Now, I like the phrase, it has a neat ring to it, but—so far—its precise meaning has eluded my occasional ruminations, which are apparently either too deep for the concept or not deep enough.

An innovator necessarily has problems with existing terminology. Definitions of words are inextricably linked with theories about the concepts which the words denote, a fact of life which has caused Austrians no end of problems in describing their approach to the profession. In view of my difficulty with certain of Professor Hutt's concepts, I can't really be certain of whether they pay their way or not in increased insight. Let the conscientious reader be forewarned: be prepared to spend many hours on the precise meaning of an occasional phrase, or hope it isn't crucial and jump over it, assuming your general impression is OK. You may end up doing both.

An occasional perplexing phrase, however should certainly not dissuade the scholar from a thorough reading of *The Keynesian Episode*. Admittedly, it's pretty harsh on Keynes and Keynesians, but the modern student accustomed to the fashion of attributing all sorts of brilliant insights (e.g., into institutional price or wage rigidities) to the murky *General Theory* should consider some of Hutt's points: the potential for discoordination via institutional rigidities was thoroughly recognized by pre-Keynesians, Keynes and his followers are largely responsible for the aggregative-macro mess, and Keynes (despite reports that he found them "silly") never formally repudiated his followers' alleged misinterpretations of his work. The policies Hutt brilliantly attacks (here and in 1963) have caused immense human suffering—he never loses sight of that, and his readers shouldn't, either.

Books taking a thoroughgoing coordination view of macroeconomic issues are few and far between. This one should not be missed.

The Theory of Social Action: The Correspondence of Alfred Schutz and Talcott Parsons

edited by Richard Grathoff, Bloomington, Ind.: Indiana

University Press, 1978, xxvi + 145 pp., \$12.50.

Reviewed by Ludwig M. Lachmann

In 1937 the Harvard sociologist Talcott Parsons sprang to fame with the publication of his book *The Structure of Social Action* in which he demonstrated that the social thought of four European thinkers, Durkheim, Marshall, Pareto and Weber, for all the difference in their backgrounds and interests could be shown to converge on a "voluntaristic theory of action." He then proceeded to outline what in his view the conceptual structure of such a theory should be.

Hayek, as an editor of *Economica*, asked the Austrian philosopher Alfred Schutz, a noted member of the Mises Circle, to review the book. Schutz soon became so fascinated with his task that what was intended as a book review turned into a "monstrous paper of about 20,000 words" which he had no hope to publish in this form.

In the late summer of 1939, soon after Schutz's arrival in this country, he and Parsons started to correspond. In November 1940 he sent the paper men-



Alfred Schutz

tioned to Parsons who commented in three long letters. The correspondence ceased in April 1941. From the tone of the letters exchanged it is obvious that by then both correspondents had become rather disappointed with each other. In the following years, however, "(b)oth kept to their decision to keep their dispute a private affair." Schutz never published his paper. He died in 1959.

The present volume consists of a foreword by Maurice Natanson, an introduction by Richard Grathoff, the editor, Schutz's paper, here called "Inquiry into the Structure of Social Action", followed by the letters exchanged between the two between October 1940 and April 1941, and a "1974 Retrospective Perspective" by Parsons, followed by another Retrospect by the editor.

The failure of two such minds to meet, let alone reach agreement, makes for sad reading. The reasons are many and varied. We can only glance at a few of them. Strange to say, one of them lies in the very closeness of the positions the two authors occupy. It sometimes makes them use similar words for different things.

In part the controversy reflects differences between philosophical schools. Parsons, like Weber, is a Neokantian while Schutz, a disciple of Husserl, espouses phenomenology. Parsons writes to Schutz: "I think what you mean essentially is an ontological reality, what a concrete real actor 'really' experiences. I think I have legitimate reasons to be skeptical that by your analysis or by any others available it is possible to arrive at anything approaching a definitive description of such a reality. I am afraid I must confess to being skeptical of phenomenological analysis." (p. 88).

To Parsons all knowledge is gained by observation and the difference between actor and observer a mere matter of degree. He looks at Schutz's "life world" with pronounced suspicion.

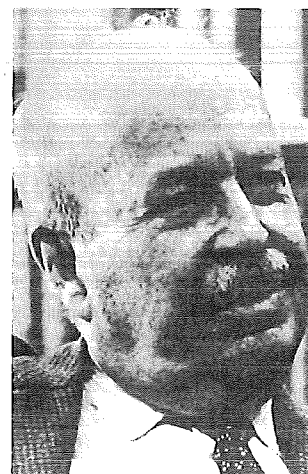
Both our authors are committed to subjectivism, but to Schutz this commitment carries implications Parsons seems able to avoid. For Schutz, Parsons does not go far enough. "Professor Parsons has the right insight that a theory of action would be meaningless without the application of the subjective point of view. But he does not follow this principle to its roots. He replaces subjective events in the mind of the actor by a scheme of interpretation for such events, accessible only to the observer, thus confusing objective schemes for interpreting subjective phenomena with these subjective phenomena themselves." (p. 36).

Both authors are Weberians with different views on the portent of Weber's work. One gains the impression that Parsons is the more sensitive to his op-

ponent's strictures, and defensive in his attitude, the more he is aware that his own interpretation of Weber is not the only one possible.

We also have to remember that at the time of their correspondence Schutz was an immigrant scholar without academic position while Parsons was well ensconced at Harvard.

What lessons does this dispute hold for Austrian economists today?



Talcott Parsons

For them, clearly Schutz is the hero of the encounter, defending a radical subjectivism against a lukewarm one, and the claims to our attention of the participant actor against those of the outside observer.

We must beware, on the other hand, of imputing to Parsons a position similar to that held today by the neo-classical orthodoxy, even though there are some parallels between the general equilibrium model and the "structural functionalism" he espoused. Parsons rejected behaviorism and positivism at a time when they were in full flood, and some eminent economists only too ready to be engulfed by it. "The position I take is certainly not that of certain schools of economic thought which restrict themselves to studying such things as indifference curves and claim thereby to have eliminated the concept of utility. That is something very close to behaviorism and I think ends up there if followed out consistently." (p. 90).

A sophisticated thinker, he had nothing in common with the typesetters of our textbook industry. Schutz found in him a worthy opponent whom, alas, he could not turn into a friend.