The Quarterly Journal of Austrian Economics

VOL. 14 | No. 4 | 474–479
WINTER 2011

Book Review

Keynes Hayek: The Clash that Defined Modern Economics

Nicholas Wapshott
London and New York: W.W. Norton and Company, 2011

John P. Cochran

The 2007–2008 financial crisis, accompanying recession, and continuing slow recovery have reinvigorated crude Keynesianism as the foundation of a "somebody in charge" policy to combat recession and high unemployment (Lemieux, 2011). Per Wapshott, "The federal government's urgent response to the financial crisis of 2007–08, initiated by George W. Bush and continued by Barack Obama, was thoroughly Keynesian, with both administrations intervening in the marketplace to head off the economy's collapse" (p. 293). In his view, "America faced an existential crisis, and as in the 1930s, a failure to act was considered so foolhardy it was barely contemplated" (p. 293). Readers familiar

John P. Cochran (cochranj@mscd.edu) is Professor of Economics at the Metropolitan State College of Denver.

with Rothbard (1962 [2000]) will be aware that it was this urge to action, the State's animal spirits (Lemieux, 2011, pp. 133–153) that turned a "garden variety recession" into the Great Depression. Critics can make a similar legitimate claim today. These recent Keynesian policies (enacted because it was "foolhardy" to even contemplate non-action), rather than helping, have actually prevented or postponed recovery. Bush's consumption–oriented stimulus of 2008 and Obama's massive 2009 stimulus package designed to support consumption spending, state and local government employment, and spending on "shovel ready" public works were either counterproductive or ineffective.

One of the few positive aspects of this classic boom-bust was a renewed interest in the Austrian (ABCT) or the Hayek-Mises business cycle theory (Cochran, 2010, p. 43, especially note 1). This renewed interest in ABCT, coupled with the Keynesian nature of the policy response, renewed interest in the 1930s debate between Hayek and Keynes (Cochran and Glahe, 1999). This renewal has been much more widespread than an earlier revival of interest in ABCT in the late 1970s and early 1980s generated by Hayek's Nobel Prize (Cochran, 2011). Interest in Hayek at that time was enhanced by the failure of the then-dominant Keynesian macroeconomics to explain or provide policies to reverse the stagflation. This stagflation had been triggered by the application of Keynesian policies and expansion and growth of government in the 1960s and 1970s (Hayek, 1979). To Wapshott, this debate was the "clash that defined modern economics." In this renewal of the debate, the ideas of Hayek and Keynes are the competing visions of the functioning of and the appropriate role of government in a market oriented economy. The battle is over the "the virtues of a free market and government intervention."

John Papola and economist Russell Roberts recently popularized this idea that Hayek and Keynes (and their differing views on the virtues of markets and individual planning versus government intervention and more centralized planning) are crucial for understanding the current economic stagnation and policy debate with two excellent and entertaining rap videos; "Fear the Boom and the Bust"and "Fight of the Century."[1]

[1] See http://econstories.tv, accessed August 25, 2011.

Journalist Nicholas Wapshott joins the fray with his new book, *Keynes Hayek: The Clash that Defined Modern Economics*. While the book was not scheduled for release until October 2011, Wapshott begin promoting the book in July through emails and a website.[2] The book, per the pre-release hype, will, according to Stanford economist John B. Taylor, bring the "Keynes-Hayek fight of the 20th century back to life, making the clash both entertaining and highly relevant for understanding economic crises of the 21st century." Sean Wilentz, professor of history at Princeton, adds, "'Nicholas Wapshott's *Keynes Hayek* is a smart and absorbing account of one of the most fateful encounters in modern history, remarkably rendered as a taut intellectual drama. Wapshott brilliantly brings to life the human history of ideas that continue to mold our world." In additions to these promises that the book will be an engaging and entertaining read, the author also promises a definitive answer to the question of who is most relevant to the recent crisis and slow recovery, while providing a definitive answer to Hick's (1967, p. 203) question, "Which was right, Keynes or Hayek?" with an end chapter "And the Winner Is…: Avoiding the Great Recession, 2008 Onward."

A delightful read it is, if one is looking for an entertaining melodrama. Maynard Keynes is cast as Dudley Do-Right, "The Glamorous Hero" (pp. 1–14) whose "economics was based on a commonsense [non-scientific?] understanding of the subject and how business worked in practice…" (p. 3). The hero was "interested in the application of economics as a means of improving the lives of others" (p. 7). Hayek is Snidely Whiplash, the hired gun from the Austrian School. The Austrian school is "more theoretical and mechanistic, deriving from an intellectual rather than a practical understanding of how business might work" (p. 3). Hayek, as an Austrian, "was consumed by economic theory for its own sake" (p. 7).

The anti-hero Hayek was out to do harm to Keynes and, by implication, the economy and the lives of others. Keynes, as Dudley Do-Right, is bent on saving innocent Nell Fenwick (the working class) from the evils of extended unemployment. Meanwhile, the ill-intentioned Snidely Whiplash (Hayek) would

[2] See https://sites.google.com/site/wapshottkeyneshayek/, accessed July 2011.

tie the innocent Nell to the rails with the chains of a laissez faire policy as the runaway train (unhampered capitalism) races unaided into depression and collapse. In 2008, as in the 1930s, Dudley triumphs. Nell (and capitalism) is saved by Keynes. The adherents of free markets, now saved from their own folly, cling to their copies of *The Road to Serfdom*, *Human Action*, and *Man, Economy and State* while ungratefully failing to "acknowledge their debt to Keynes for having saved capitalism twice in eighty years" (p. 295).

On the grounds presented by Taylor and Wilentz, the book is a success. Wapshott provides engaging commentary and gossipy remembrances of the interactions of Hayek, Keynes, the Cambridge circus, and the economists of the London School of Economics during the 1930s. He addresses Hayek's non-response to *The General Theory*, but as throughout the entire book, Hayek is portrayed in a very unsympathetic manner. There is no recognition that during this time Hayek produced the works incorporated into *Profits, Interest, and Investment* (1939) many of which, while not directly referring to Keynes and the *General Theory*, provided theoretical arguments undermining much of Keynes's analysis and especially much of Keynes's writing for popular audiences supporting deficit spending on public works to reduce unemployment and end recession.

While "Hayek Blinks," "Keynes Takes America." Keynes, "rather than burying himself in abstruse theories channeled his energies toward practical remedies" (p. 155). Hayek, ever concerned with "abstruse theory" is first "Hopelessly Stuck" in Chapter 6, and is then diverted on a journey which is a "Road to Nowhere" ultimately ending in years in the "Wilderness." Hayek's years in the wilderness coincide with three decades of "unrivaled prosperity," 1946–1980, which Wapshott labels as the "Age of Keynes." However, while the 1950s and 1960s was the age of Keynes in American academia, policy was hardly Keynesian. As recognized by Keynes's biographer Skidelsky (2000, p. 500), referring to this period, he writes, "At the time this [the prosperity] was attributed to Keynesian policies themselves, but this turns out to be unproven." It is also widely recognized that this era of prosperity really ended not in 1980, but with the stagflation of the 1970s. The stagflation was a direct result of decades of overly expansionary monetary policy and the first attempts in the U.S. to actually put Keynesian fine tuning into practice. The stagflation was ended, not as suggested by Wapshott (with Keynesian remedies), but by liberalizations more in line with a Hayekian vision of institutions that support economic growth (Shleifer, 2009).

The book, however, does not provide an academic, sober assessment of the impact of the ideas of Keynes and Hayek on recent events. Nor does it provide a balanced answer to who was right (Garrison, 1999, pp. v–vii). Wapshott liberally quotes Hayek, most frequently from the excellent recent Salerno-edited volume of Hayek (2008) which includes many of his most important contributions. Wapshott even correctly indentifies Hayek's reliance on Austrian capital theory and in Keynes's case, a lack of a nuanced capital theory (Cochran and Glahe, 1999, and Horwitz, 2011) as the source of the intellectual gap separating Hayek and Keynes. Wapshott has clearly read and can quote Hayek's technical work, usually out of context. But he has apparently benefited little for this reading. He remains totally committed to a macro as opposed to micro understanding of how an economy works. Wapshott's assessment of the relative merits of Hayek and Keynes will appeal to and be quoted by the many planners of all parties firmly committed to the ideology that a modern economy truly needs somebody in charge.

However, Wapshott's drama is not just a melodrama, but also a fairytale. Readers truly looking for a better understanding of the crisis must look elsewhere. If one wants a better picture of how the world got into this mess and how applying the ideas of Keynes actually played out in the real world, Lemieux (2011) would be a good starting point.

REFERENCES

Cochran, John P. and Fred R. Glahe. 1999. *The Hayek-Keynes Debate: Lessons for Current Business Cycle Research*. Lewiston, Queenston, Lampeter: Edwin Mellen.

Cochran, John P. 2010. "Capital in Disequilibrium: Understanding the 'Great Recession' and Potential for Recovery." *Quarterly Journal of Austrian Economics* 13, no. 3: 42–63.

——. 2011. "Hayek and the 21st Century Boom-Bust and Recession-Recovery." *Quarterly Journal of Austrian Economics* 14, no. 3: 261–285.

Garrison, Roger W. 1999. "Foreword." In John P. Cochran and Fred R. Glahe, eds., *The Hayek-Keynes Debate: Lessons for Current Business Cycle Research*, Lewiston, Queenston, Lampeter: Edwin Mellen, pp. v–vii.

——. 2001. *Time and Money: The Macroeconomics of Capital Structure*. New York: Routledge.

Hayek, Friedrich A. 2008. *Prices and Production, and Other Works on Money, the Business Cycle, and the Gold Standard*. Ed. Joseph T. Salerno. Auburn, Alabama: Ludwig von Mises Institute.

——. 1979. *Unemployment and Monetary Policy: Government as Generator of the "Business Cycle."* San Francisco, Calif.: Cato Institute.

——. 1939. *Profits, Interest, and Investment and Other Essays on the Theory of Industrial Fluctuations*. Clifton, N.J.: Augustus M. Kelley. 1975.

Hicks, John R. 1967. "The Hayek Story." In *Critical Essays in Monetary Theory*. London: Oxford University Press, pp. 203–215.

Horwitz, Steven. 2011. "Contrasting Concepts of Capital: Yet Another Look at the Hayek-Keynes Debate." *Journal of Private Enterprise* 27, no. 1: 9–27.

Lemieux, Pierre. 2011. *Somebody in Charge: A Solution to Recessions?* New York: Palgrave Macmillan.

Rothbard, Murray N. 1962. *America's Great Depression*, 5th ed. Auburn, Ala.: Ludwig von Mises Institute. 2000.

Shleifer, Andrei. 2009. "The Age of Milton Friedman." *Journal of Economic Literature* 47, no. 1: 123–135.

Skidelsky, Robert. 2000. *John Maynard Keynes, Volume Three: Fighting for Freedom 1937–1946*. New York and London: Viking.

Wapshott, Nicholas. 2011. *Keynes Hayek: The Clash that Defined Modern Economics.* New York and London: W. W. Norton.