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LI-Paper

# Friedrich August von Hayek: A Short Appreciation

KURT R. LEUBE\* • March 2012



“Before we explain why people commit mistakes, we must first explain why they should ever be right.”

*F. A. von Hayek*

It is 2012, and lest we forget one of the most seminal minds of our times, we should recall the important work of Friedrich August von Hayek who died twenty years ago, on March 23, 1992, aged 93.

F. A. von Hayek grew up in a typical Austrian family that could lay claim to an academic tradition of well over three generations. At the age of 18, to avoid his failing at several schools in Vienna he voluntarily joined the Austro-Hungarian Army and served as an artillery officer until the end of World War I. Immediately after his return from the Italian front, Hayek enrolled at the University of Vienna and, only three years later obtained his law degree (Dr. jur.). While Hayek studied for his second doctoral degree in political science (Dr. rer. pol.) which he earned in 1923, he began to work under Ludwig von Mises’s directorship in the “Abrechnungsamt”, a Vienna based office for the settlement of pre-war debts. As the most eminent scholar of the third generation of the Austrian School of Economics, Mises (1881-1973) soon became Hayek’s mentor and in 1927 they succeeded in founding the Austrian Institute for Business Cycle Research which soon gained high academic reputation under Hayek’s and later Oskar Morgenstern’s leadership.

## A force against Keynesian fallacies

The culturally vibrating climate of interwar Vienna provided the stimulating background for many scholarly circles and schools, such as the Vienna Circle of Philosophy, the Vienna School of Psychoanalysis, or the Mises Private Seminar. This famous Seminar which between 1921 and 1934 Mises conducted off campus in his Chamber of Commerce office was the nucleus of the fourth generation of the Austrian School, the most important representative of which was Hayek. It is remarkable that far more than half of its participants later became world-famous in their respective academic fields. Yet, with Nazi terror on the rise and almost no prospects of ever gaining access to an adequate academic position, all but very few

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of these uniquely talented scholars left Austria for good. Schumpeter and Hayek were the first; many others were soon to follow. This brain drain led to devastating consequences in the intellectual life in Austria and Germany, which still can be felt today.

Hayek's first book, *Monetary Theory and the Trade Cycle* (1929), at once set a standard in modern business cycle theory and is still valid. One of the most striking characteristics of the "Austrian" business cycle theory is Hayek's insight that any shortage of capital immediately causes a crisis. While classical economic theory never elucidated what causes such a shortage, Hayek made it clear that any *overinvestment* leads to "scarcity of capital", unavoidably compelling a decline in investment and hence leading to the loss of a part of real capital, incurred because of the excessive investment rate.

Impressed by Hayek's new business cycle theory, Lord Robbins invited him to lecture at the London School of Economics in the winter of 1931. The lectures were so successful that he was offered the position of "Tooke Professor of Economic Science" almost immediately thereafter and he accepted almost without hesitation. At this time, when John Maynard Keynes' new theories began to dominate academic and political life it was unavoidable for Hayek not to be immediately drawn into a fundamental debate with Keynes. Due to their inflationary character Hayek opposed these theories vigorously and thus became the leading intellectual force against Keynes and his followers. However, in view of a recession with huge unemployment rates it became politically obvious that Hayek's approach of "waiting out the crisis" was doomed to be overshadowed by the theoretically seriously flawed yet politically attractive "Keynesian Revolution" with easy "solutions" and massive government interventions. It is a regrettable but undeniable fact that economics much more than any other academic discipline is liable to the periodical reintroduction of popular fads and irrepressible superstitions.

While being deeply involved in these heated debates, Hayek at the same time opened yet another intellectual front and published the three famous essays which forever shattered the foundations of socialism. These essays were later collected in his *Individualism and Economic Order* (1948). The painful collapse of socialism as a viable political system in 1989 is the belated empirical proof of Mises' as well as Hayek's insights. Hayek's interest in technical economics culminated in his *The Pure Theory of Capital* (1942) which must be rated as one of the most penetrating books ever published in this complex field.

## The theorist of knowledge

But his intensive work on the insoluble economic and moral problems of socialism, the terror of fascism, and the outbreak of World War II made him write *The Road to Serfdom* (1944). This courageous bestseller of the immediate post-war years, in the meantime translated in some 20 languages, was a revelation for those who wanted freedom. Hayek clearly showed there the ideological links between

socialism and fascism and demonstrated that no variety of socialism, no matter what its name or however modified by trendy adjectives, carries with it any adequate provisions for the preservation of economic and political freedom. Thus the popular view of the convergence of economic systems is rooted in pure economic error and is a “pretense of knowledge”. This book made him again world-famous. An excellent condensation of it appeared 1946 in “Reader’s Digest” and there was also a cartoon book made.

Hayek’s essays the “Counter-Revolution of Science” (1941) and “Scientism and the Study of Society” (1942/43) contain probably the most effective refutation of the popular superstition that the methodology of the natural sciences can be utilized to explain social phenomena and human action. These works are collected in his *The Counter-Revolution of Science* (1952, 1989) and are together with his classic “The Use of Knowledge in Society” (1945) a key to understanding of his work. In this path-breaking article on the *division of knowledge*, Hayek shows how the unorganized knowledge of the particular circumstances of time and place will spontaneously bring about a *social order*. The independent interaction of millions of individuals, each possessing only bits and pieces of information of which beneficial use might be made, creates circumstances that cannot be conveyed to any central authority. The price system is therefore a system of signals and the only mechanism that communicates information and enables us to adapt to circumstances of which we know nothing. Our whole modern social order and well-being thus rests on the possibility of adapting to processes that we do not know.

In 1947 Hayek organized an international conference of economists, philosophers and historians to discuss and exchange ideas about the nature and the intellectual means to strengthen a free society. This important meeting in Switzerland turned out to be instrumental for the foundation of the exclusive Mont Pèlerin Society, an international association of classical liberal scholars.

## Rules for social life

By the end of 1949, Hayek left the London School of Economics, spent the spring term of 1950 in Fayetteville, Arkansas and joined a congenial group of scholars with Milton Friedman (Nobel Prize 1976), George Stigler (1989), Ronald Coase (1991), or Gary Becker (1992) at the University of Chicago in the fall of the same year. Among his many works published during his twelve Chicago years only two books shall be singled out. Although *The Sensory Order* (1952) is probably his most difficult and least known work it nevertheless contains some of his most original and important ideas. The preliminary thoughts for this discourse in theoretical psychology date back to the early 1920s, when Hayek, still uncertain whether to become a psychologist or an economist was inspired by the philosophical works of Moritz Schlick and his second degree cousin, Ludwig Wittgenstein. The second book to be mentioned is Hayek's classic *The Constitution of Liberty* (1960) – truly one of the great books of our time. Here Hayek further

developed his idea of “spontaneous order”, and laid down the ethical, legal and economic principles of freedom and free markets. While for many social philosophers the chief aim of politics consists in setting up an ideal social order through utopian reforms, Hayek's main task is the finding of rules that enable men with different values and convictions to live together. These rules are established to permit each individual to fulfill his aims, and to limit government action. The social order develops spontaneously through the interactions of individuals obeying these general rules. It is distinguished from the constructivist approach, which interprets all social orders as the product of conscious design.

## Late European years

In 1962 Hayek returned to Europe and joined the University of Freiburg/Breisgau. Among the many works which he published there, again only two shall be mentioned. Hayek dedicated his *Studies in Philosophy, Politics and Economics* (1967) to his friend the influential Austrian-born philosopher Sir Karl R. Popper (1902-1994). This book covers Hayek's works dating from the early 1950s to the mid-1960s and contains classics such as “The Results of Human Action but not of Human Design” and “The Intellectuals and Socialism”. His *Freiburger Studien* (1969) is a collection of important German essays, including his seminal “Competition as a Discovery Procedure” and “Kinds of Order in Society”.

After becoming professor emeritus at the University of Freiburg in 1969, he accepted a professorship at the University of Salzburg (Austria) which he kept until 1977. In spite of his poor health and relative intellectual isolation, Hayek nevertheless was able to produce a number of significant works. Among others, he published in 1973 the first volume of his trilogy *Law, Legislation, and Liberty*. Here Hayek argues that a spontaneous social order and an organization are quite distinct and that their distinctiveness is closely related to the two different kinds of rules that prevail in them. These are the “end-state rules” and the “process rules”. In the second volume, published in 1976, Hayek analyzed the misleading yet politically so popular term “social justice”. This narcotic phrase can have meaning only in an organization where strict distributive rules apply, but cannot be used as a measure for income distribution in the spontaneous order of free societies.

In 1974, very much to his own surprise he was awarded the Nobel Prize in Economics. Probably for political reasons he had to share the Prize with a complete intellectual adversary, Gunnar Myrdal, the force behind the socialistic Swedish welfare state, the model which was once highly praised and copied, however turned into a complete failure.

At the peak of Neo-Keynesianism, Hayek in his Nobel lecture on “The Pretense of Knowledge” (1974) refuted once again the erroneous assumption of this politically popular superstition. This prestigious distinction clearly inspired the intellectual revival of the “Austrian School of Economics” and helped Hayek to finally step out of his isolation, if only temporarily. In typical opportunistic fashion,

suddenly politicians, intellectuals, or even entire scholarly institutions and universities began to shower him with prestigious titles or orders and honorary degrees.

At the age of 78 he decided to leave Austria again and moved back to Freiburg where he completed the third volume of his trilogy *Law, Legislation, and Liberty* in which he refined his critique of democracy and developed the principles of a political order for free people. As a side product, he published his *Denationalization of Money* in 1977. In this revolutionary work he argues that inflation can be avoided only if the monopolistic power of issuing money is taken away from government and/or state authorities, and private industry be given the task of promoting competition in currencies.

Hayek continued to lecture, write and travel extensively until the mid-1980s when he became ill and never fully recovered. Thus, he could not complete his last book *The Fatal Conceit* (1989) in which he hoped to develop further his theory of cultural evolution and expose once more the “errors of constructivism”. Due to his inability to manage the huge manuscript, this book has been heavily edited and not always in the most sensitive way. Regrettably thus, it is not his best work.

His lifework arose and developed from a comprehensive approach to various disciplines that condition and influence one another. His publication list contains well over 40 books and some 300 scholarly essays and articles. As a scholar, a teacher, and a patient fatherly friend, Friedrich August von Hayek came as close to the vanishing ideal of a gentleman as perhaps human frailty will ever permit.



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