

# Hayek, Keynes and the State

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## 1. Introduction

In this paper, I discuss some aspects of the inter-relations between Hayek and Keynes, as a way of raising some questions about Hayek's ideas concerning the state. Hayek sent Keynes a copy of *The Road to Serfdom* (Hayek, 1944) on its publication. In the course of a letter to Hayek in response, Keynes raised a problem about how Hayek would demarcate between legitimate and illegitimate forms of state activity. In my view, Hayek had, in *The Road to Serfdom*, already implicitly furnished a fairly clear answer to this question. But it may have been an answer about which he became uneasy - not least, perhaps, because of the respects in which Keynes, himself, might seem to have embraced these very ideas, and the kind of interpretation which he gave to them.

Whatever, historically, may have motivated Hayek,<sup>1</sup> he subsequently - as I here document, from archival materials - returned to what looks very much like the question which Keynes had put to him. Hayek then develops a distinctive answer to that question; one which is by no means obviously the same as that which may be extracted from *The Road to Serfdom*. It is a view which sees the legitimate sphere of the activity of the state as being given by what is compatible with the rule of law, as interpreted in the *Rechtsstaat* tradition. (That is to say, of a tradition in which law is seen as universal in its form, government is seen as itself subject to the law, and in which the formal requirements which are imposed on the law are seen as endowing it with a content that echoes Kantian themes within moral philosophy (compare Hayek, 1955; Shearmur 1996a).)

Now, the ideal of the rule of law (which I discuss later) is to be found in *The Road to Serfdom*; and Hayek there uses it as a critical weapon against central economic planning. What he does not do there is to consider how it applies to his own views. My argument, in this paper, is that subsequent to Keynes' letter to him, he gives a central position to this ideal. Hayek suggests that it offers the basis upon which one can demarcate between legitimate and illegitimate forms of state activity. Clearly, however, if he takes this view, he needs to show that his own account of the legitimate activities of the state is, itself, compatible with this ideal. And this, indeed, is his concern in the sections of *The Constitution of Liberty* (Hayek, 1960) which deal with problems of governmental policy.

I suggest that this leads Hayek to an interpretation of liberalism which contrasts with that of Keynes. (I here argue against a strand of argument in the recent work of Andrew Gamble (Gamble, 1996), which suggests that their views were, in fact, closer than is often supposed.) However, I also tentatively question the adequacy of these views of Hayek's, to the concerns that he developed in *The Road to Serfdom*. (A full appraisal of this issue would require an assessment of Hayek's treatment of both the form and the scope of governmental activity in *The Constitution of Liberty*; a task which I cannot undertake here.)

If I am correct in this judgment about the adequacy of Hayek's views, this poses the problem: can forms of governmental activity which would *not* be compatible with Hayek's ideas about the rule of law be reconciled with his concern for individual liberty? I conclude the paper by suggesting that they can, referring briefly to some suggestions which I have discussed more fully elsewhere (Shearmur, 1996a).

## 2. Hayek and Keynes

Hayek was in disagreement with Keynes both about the theoretical approach that one should take to the understanding of trade cycles, and also with regard to the kinds of policy measures that were appropriate to the situation in which Britain found itself in the 1930s. However, he did not engage with Keynes, in response to Keynes' *General Theory* (Keynes, 1936). In his old age, Hayek was to return to the criticism of Keynes, both in respect of what he claimed to be the inflationary consequences of 'Keynesian' economics, and also because of the critical attitude towards traditionally accepted moral rules which he saw Keynes as having adopted, under the influence of G. E. Moore.

In his 'Introduction' to *Contra Keynes and Cambridge* (Hayek, 1995), Bruce Caldwell reviews in some detail the history of the interactions between Hayek and Keynes. In particular, he recounts the story of how, from the 1930s through into the period just after the Second World War, Hayek's programmatic approach within economics lost influence to that of Keynes. The collapse was dramatic. From Hayek's being a key figure within economics in England, especially in London, things changed such that, by the end of this period, virtually only Lachmann and Hayek remained proponents of Hayek's approach.<sup>2</sup> And even Hayek was soon to give up on technical work within economics in order to pursue issues in the field of social philosophy, methodology and the history of ideas.

Andrew Gamble has recently argued (Gamble, 1996, chap 7) that while Hayek depicted Keynes as a proponent of 'false' individualism, they were in fact both attached to the British tradition of liberalism; to Hayek's 'true' individualism. However, Gamble suggests, they took different views of what ailed it. Gamble writes (Gamble, 1996, p. 159): "For Hayek, ... it is an inheritance which is in danger of being lost because of intellectual error; whereas for Keynes, it is a living reality which is in danger from ossified forms of thought and stupidity, and can be preserved only through creative political action". Gamble argues that they were also similar in their political elitism - although, on this, he suggests that Hayek was more of a democrat than was Keynes. I will return to the charge of elitism at the end of this paper. My main concern here, however, is rather different; it relates to Keynes' reaction to Hayek's *Road to Serfdom*. To appreciate this, it might be useful to start by saying something about that book.

*The Road to Serfdom* is, in my view, best understood as having two, related, roots. On the one side, it comes out of Hayek's work on the problems of economic calculation under socialism (see, notably, Hayek (1948)). This was of key significance in the development of Hayek's thought, in the sense that it was a source not only of some of his major ideas within economics (notably, his interest in the information-transmitting characteristics of prices, and his shift away from an economics that was centered upon general equilibrium theory (Caldwell, 1995; Shearmur, 1996a)), but also of his ideas on social theory. As I have argued elsewhere (Shearmur, 1996a) Hayek's view of society was of an extended market order, his conception of which was informed by his understanding of the economic calculation debate. That is to say, Hayek's view of the social order within which his (Western) readers are living, is of it as an extended market-based society, within which people practise the division of labour. Their actions, taken on the basis of knowledge which is, essentially, socially distributed, are coordinated by means of their acting on the basis of prices, within the ambit of the rule of law. Further, such a society is characterized by the fact that, within it, people cannot be - and do not need to be - conscious of the full ramifications of their actions. Indeed, on Hayek's account, prices supply to them a composite summary (based on what has happened in the immediate past) of other people's evaluations of their possible activities and uses of resources, disaggregated action on the basis of which attunes each individual to such evaluations.

On the other side, there is Hayek's interpretation of the character of Nazi Germany and, more generally, of totalitarianism. These, he argued, were the products of an attempt at central economic planning.<sup>3</sup> Not only, on this score, was Nazism not to be understood as the antithesis of communism,<sup>4</sup> but the respects in which the regimes of Hitler and of Stalin resembled one another were, in his view, to be explained by the fact that they each departed in a similar way, in their favored forms of economic organization, from the characteristics of a systematically market-based society.<sup>5</sup>

Hayek's *Road to Serfdom*, itself, seems to me best understood as offering an argument that a loss of freedom, and many of the unlovely features of regimes such as those of Hitler and of Stalin, will follow, as an unintended consequence, if the aims of economic planners are systematically pursued. It was not so much a prophecy that things will happen, as a warning that they will, if certain things are done.<sup>6</sup> On my understanding, Hayek's own view was that things which could have posed a serious threat to liberty did, indeed, subsequently occur in the United Kingdom, as a consequence of the regulations which were introduced to foster economic planning.<sup>7</sup>

It would, however, be a mistake to read *The Road to Serfdom* as consisting simply of such a warning. For, in it, Hayek also put forward some positive political ideas of his own: *The Road to Serfdom*, in effect, also sets out to offer a restatement of a vision of the liberalism that he favours. From the point of view of this paper, it is significant to note that his account has two features. First, he stresses the importance, for a free society, of the rule of law. Second, he is not a proponent of laissez faire; rather he is concerned that governmental intervention in the economy shall take place in ways that do not threaten that market-based social order which, in his view, is of such importance for both the liberty and the well-being of citizens.

### 3. Keynes and The Road to Serfdom

Despite their disagreements over economic issues, Hayek had got to know Keynes personally, notably when the L.S.E. was in exile in Cambridge, and they seem to have had good personal and professional relations (Hayek, 1994, p. 91). It was, in consequence, no surprise that Hayek was to send Keynes a copy of *The Road to Serfdom*. In a well-known letter that Keynes sent to Hayek in response, he took what was in some ways a surprisingly positive attitude towards the book. But he also offered some criticism. The heart of his criticism - which Gamble broadly endorses in his book - is conveyed by the following.

Keynes had noted that, in this work, Hayek is critical of 'laissez faire'. But he commented to Hayek, in relation to what activities government should undertake (Keynes, 1980, pp. 386-7): 'You admit here and there that it is a question of knowing where to draw the line. You agree that the line has to be drawn somewhere, and that the logical extreme [i.e. laissez faire] is not possible. But you give us no guidance as to where to draw it.' Keynes then goes on to argue that: '...as soon as you [Hayek] admit that the extreme is not possible, and that a line has to be drawn, you are, on your own argument, done for, since you are trying to persuade us that as soon as one moves an inch in the planned direction you are necessarily launched on the slippery slope which will lead you in due course over the precipice.'

In my view, Keynes' criticism misses the mark, and rather badly. For it seems to me to misunderstand, in a significant way, the thrust of Hayek's argument. For Hayek is not, in *The Road to Serfdom*, arguing that all governmental activity in the economy represents steps on 'the road to serfdom'. Rather, what he is doing is to argue that there are dangers in some forms of governmental activity, and, in effect, he sets out to tell us what it is, and what it is not, in order for the government to do.

The heart of Hayek's case is fairly simple. He wishes to argue, first of all, that the central direction of the economy - so-called 'economic planning' - is a disaster. It will not, Hayek argues, accomplish what its proponents want from it; and it will, indeed, if attempts are made to implement it, lead to the kinds of problem that he highlighted in his *Road to Serfdom*. He also wishes to argue, however, that if one has a market-based society, then there are some things which one cannot at the same time achieve; for example, outcomes of market-based economic relations that also fit some pattern of 'social justice'. And, he cautions us that if it is attempted to *make* the mechanisms of a market-based society deliver such outcomes, the result will be a gradual move to a centrally-planned society, and to serfdom.

All this, emphatically, does not mean that Hayek is a proponent of *laissez faire*. Indeed, Hayek has, in *The Road to Serfdom*, what could be described as a fairly full agenda for governmental action. In broad terms, he looks to the government to perform the following functions.

First, Hayek wishes that government should provide a framework within which economic activity and other forms of voluntary cooperation between people can take place. This is not a matter of simply accepting institutions as they are, but also of improving upon them; indeed, as Hayek says (Hayek, 1944, p. 17), of 'deliberately creating a system in which competition will work as beneficially as possible'. He elaborates upon this point, when he says (Hayek, 1944, p. 36) that: "in order that competition should work beneficially, a carefully thought-out legal framework is required... [adding that] neither the existing nor the past legal rules are free from grave defects". It is important, in this connection, to note that he refers not just to the initial setting-up of a framework of activity, but also to 'an intelligently designed and *continuously adjusted* legal framework' (italics mine) (Hayek, 1944, p. 39).

Second, he took the view that the government should provide various things which he thought important for the working of a market-based economy, but which he did not think that markets could themselves provide; what he referred to as the 'positive requirements of a successful working of the competitive system' (Hayek, 1944, p. 38). These, he explained, included the 'adequate organization of certain institutions like money, markets and channels of communication'; and also 'the prevention of fraud and deception (including exploitation of ignorance)' (Hayek, 1944, p. 39).

Third, there was what one might, more generally, call governmental action to address a list of market failures. Hayek offers examples, in this context, of such things as the provision of signposts and indeed of roads; of the need to address externalities created by deforestation and certain kinds of farming, and, in addition, problems - like those in modern towns - 'caused by close contiguity in space' (Hayek, 1944, p. 39 and, for the quotation, p. 48). He also considers as legitimate objects of state action such issues as the control of weights and measures, the need for building regulations and factory laws (although he clearly has misgivings about the wisdom of some specific examples of these), and in addition wishes the state to have a role in the spreading of knowledge and information, in order to assist mobility (Hayek, 1944, pp. 81 and 95). Further, where monopoly is inevitable, he favours state regulated private enterprise; that is to say, something like the American model (Hayek, 1944, p. 198).

Finally, Hayek favours welfare measures of various kinds. He discusses, in this context, such things as the provision or facilitation of sickness, accident and social insurance; of insurance for earthquakes and floods, and the taking of actions to handle the welfare consequences of fluctuations of economic activity and employment. As remedies for unemployment, he discusses as alternatives monetary policy and a program of public works; and, while he would clearly welcome it should the former prove sufficient, he does not rule out the need for the latter (Hayek, 1944, pp. 120-2). In the course of its discussion, however, he writes (Hayek, 1944, p. 122): in

experiments in this direction [i.e. in tackling such problems by way of public works], we shall have carefully to watch our step if we are to avoid making all economic activity progressively more dependent on the direction and volume of governmental expenditure".

At the same time, he explicitly states that such governmental activity does not amount to a form of planning which 'constitutes... a threat to our freedom'. (Indeed, it is striking that, in his unpublished *Postscript to The Road to Serfdom* (1948), Hayek draws attention to the fact that he had made this point in his book, and explains that while he dissents from 'Keynesian' views, his reasons for doing so are not related to the main argument of the book. Indeed, he goes out of his way to stress that his own views, while differing from those of Keynes, would call for government to pursue an active monetary policy.<sup>8</sup>) Hayek also accepts what might seem to be quite vigorous forms of intervention, with an eye to handling problems of welfare, writing that: 'adequate security against severe privation, and the reduction of the avoidable causes of misdirected effort and consequent disappointment will have to be one of the main goals of policy' (Hayek, 1944, p. 132).

Now, if we consider all this material, it is clear that Hayek can, in no sense, be described as a proponent of laissez faire; indeed, it is in some ways surprising that he should have been taken, by his critics, to hold such views. It is understandable that his work was found upsetting by some, as the kind of planning of which he was critical was dear to the hearts of many people at the time. In respect of his argument against that, Hayek was, surely, correct. The problem about Hayek's argument, rather, was that he *might*, indeed, seem to have fallen into exactly the difficulty that Keynes had highlighted; namely, was he not arguing that governmental intervention led us onto the 'road to serfdom', while - as we have seen - himself being willing to advocate a fairly full program of just such action? I have already stated that I do not think that Keynes was, here, quite right. Let me now turn to explain why.

#### 4. Hayek and the State in The Road to Serfdom

It seems to me that Hayek has a fairly simple response to Keynes' criticism available to him. It is that the entire thrust of his book was not against governmental action, but instead, that it explicitly addressed the issue of what government should and should not do. He argued, first, that there were some things that looked attractive to people of good will (for example, a planned economy), but which would prove a disaster, if attempts were made to implement them. Second, he argued that some other goals, if pursued directly by way of governmental intervention in the economy, would also lead to dire results. Third, there were some matters - such as, say, the regulation of working hours - which he argues to be problematic not in principle, but as a matter of degree.<sup>9</sup> Fourth, and more positively, his argument was that we should appreciate the role played by markets and other forms of spontaneous order, and both foster them, and make sure that we pursue our other goals in ways that are complementary to, rather than disruptive of, both them and, more generally, a market-based social order.

Indeed, there is a sense in which this final message of Hayek's might be seen as summed up in something that Keynes wrote to Hayek when he first received *The Road to Serfdom*. It was written prior to the well-known letter, to which I have earlier referred. Keynes wrote in an appendix to a letter which he wrote to Hayek on matters connected with *Economica*, of which Hayek was then the editor:<sup>10</sup>

I have still to thank you for kindly sending me "The Road to Serfdom". I only glanced at it at present, but am taking it away to read over Easter. It looks fascinating. It looks to me in the nature of medicine with which I shall

disagree, but which may agree with me in the sense of doing me good. Something to be kept at the back of one's head rather than at the front of it. But it is just as serviceable a public act to get the right packings in the back of people's heads as the right impulse to action in the front of them.

What I had in mind, in commenting that this could be seen as summing up one lesson from Hayek's work, is that Keynes is here suggesting that a lesson to be learned from Hayek's work is - in large measure - one that those involved in the design and implementation of policy should internalize; namely, that they should not do things which would serve to damage a market-based social order. From this point of view, many of Keynes' further reactions, in his later and well-known letter, serve to elaborate much the same point. He clearly sees himself in a measure of disagreement with Hayek, in the sense that he thinks that more by way of planning can safely be done than Hayek would countenance. But he also says (Keynes, 1980, pp. 386-7): "...planning should take place in a community in which as many people as possible, both leaders and followers, wholly share your moral position. Moderate planning will be safe if those carrying it out are rightly oriented in their own minds and hearts to the moral issue".

By this, however, Hayek was horrified. But on what grounds? In part, it is, clearly, that he did not agree with Keynes that 'moderate planning' was acceptable, if this meant the kinds of things against which he had argued. But there was another sense in which Hayek seems to have been alarmed; namely, by Keynes' stress upon what can reasonably be interpreted as discretionary activity on the part of an elite. (It is also possible that, reflecting on these issues, and, more generally, on the critical reception of *The Road to Serfdom*, Hayek is led to consider that his own approach, in *The Road to Serfdom*, has been problematic, in that he has criticized others on the grounds of the incompatibility between their favoured approach and the rule of law, but has not examined whether his own views would also pass such a test.) At any rate, from this point onwards Hayek places emphasis upon a strand of thought which is distinctive - and which may be contrasted with the approach which is to be found in his *Road to Serfdom*. It is a view which places greater and greater emphasis upon a particular interpretation of the idea of the rule of law and which, in the end, offers a response to Keynes' question about the demarcation between legitimate and illegitimate governmental activity in terms of the ideal of the rule of law. This approach is not quite the same as that which was set out in *The Road to Serfdom*; for there, as I have indicated, he implicitly offered a response to the problem that Keynes posed in terms of Hayek's own economic and social theories about the character of a market-based society. And it is by no means obvious that all the activities of government, to which Hayek referred there, could be accomplished in ways which are compatible with his understanding of the rule of law.

In *The Road to Serfdom*, and elsewhere, Hayek offers a distinctive account of liberalism. It is one in which stress is placed upon individual freedom and a market economy, where these are united with a particular account of the state. The liberal state is presented by Hayek as a *Rechtsstaat*, operating under the rule of law. This idea is set out already in *The Road to Serfdom*. For example, democracy is to be understood not just in terms of the pursuit of shared purposes, but also as operating under fixed rules (Hayek, 1944, p. 71): 'If democracy resolves on a task which necessarily involves the use of power which cannot be guided by fixed rules, it must become arbitrary power.' And he there elaborates on the way in which the idea of the rule of law (which is to be interpreted not in a purely formalistic sense, but in line with the Continental *Rechtsstaat* tradition; a point which is best clarified in his *Political Ideal of the Rule of Law* (Hayek, 1955)), is of significance because it allows for individual freedom, choice, and the use of socially divided knowledge (Hayek, 1944, pp. 75-6). The key issue, is

that the individual can foresee the actions of the state in advance (Hayek, 1944, p. 81), and Hayek admits that this will have the consequence that the specific *effects* of state action will, then, be unpredictable (Hayek, 1944, p. 76).

However, while these ideas are set out in *The Road to Serfdom*, and while he uses them there as a stick with which to beat the proponents of economic planning, he does not, there, discuss how these ideas relate to his own views about governmental action. The latter, rather, could be taken - as Keynes was to interpret them - as suggestions addressed to an elite, as to how they should steer the ship of state.

His ideas about the rule of law come, with the passing of time, to play a particularly important role in Hayek's work. Already in a talk that Hayek gave about *The Road to Serfdom* in the United States, in 1945 (a transcription of which is held in the Hayek Archive at the Hoover Institution), he referred to the need for a clear set of principles to distinguish between the legitimate and illegitimate fields of governmental activities, and describes himself as having addressed that task, in his book.<sup>11</sup> At the same time, there is a note of ambivalence in Hayek's account, in that he also indicates that this is a task which is still to be undertaken.

I would take the task which is still to be undertaken as his showing that his own account of the legitimate role of state action is compatible with his ideas about the rule of law. It is important, in this context, to note that Hayek's account is still implicitly addressed to a decision-making elite. But he wishes to show that the policies which he wishes them to implement are compatible with the rule of law. For Hayek, compatibility with the rule of law is a necessary (but not sufficient) condition for policy to be in order: he still, from time to time, refers to policies which would be permissible on this basis, but which he thinks would be unwise. At the same time, the ideal of the rule of law has, in his view, the dual characteristic of safeguarding people's freedom of action (as argument for which he develops at length in *The Constitution of Liberty* (Hayek, 1960)), and of being incompatible with a centrally planned economy.

This very task, I would like to conjecture, then becomes the agenda that Hayek addresses, in his writings on political issues during the late 1940s and 1950s. Indeed, if I am right, one could see all of this work of Hayek's as offering a response to the criticism that Keynes had made of his work, in the material quoted in section 3, above. A full argument to this effect would take more time - and underlying research - than it is possible for me to undertake in the present paper. But I would like to suggest that this view is plausible, on the basis of a limited amount of additional evidence from unpublished materials in the Hayek Archive.

My first port of call is the *Postscript to The Road to Serfdom* (1948), to which I have already had occasion to refer. In this connection, after briefly discussing his ideas about monetary policy, Hayek states that he attaches great importance to the idea that monetary policy should be guided by known rules, and he is sharply critical of a discretionary approach.<sup>12</sup> That is to say, he is indicating that his own favoured response to problems of trade cycles needs to be compatible with the rule of law.

Second, there is a paper of Hayek's, dated 1950, entitled 'The Meaning of Government Interference'.<sup>13</sup> In this, Hayek raises the question of what kind of governmental action is legitimate, and answers it in terms of the idea of equality before the law. He stresses again - as was done in *The Road to Serfdom* (and also in the unpublished 'Postscript') - that in saying this, he does not mean that all action that is on this basis permissible, will be wise. And he also goes out of his way to argue that if such a restriction is imposed, it may mean that we prevent government from doing things which we would judge to be good. The advantage, to Hayek, of the argument that he is offering, is that it would seem to him to be incompatible with economic planning of the kind of which he is critical, and that it would be incompatible

with the discretionary granting of licenses, permits, and allocations, and with price fixing, as well as with most forms of quotas and subsidies (unless the latter were offered to anyone who wished to undertake the activities in question). He again recognizes that some arrangements which would pass his test nevertheless might well be problematic even if formally in order (e.g. if a legislature were to keep changing the character of such restrictions, on a frequent basis), and he argues that rules should be kept stable, for extensive periods of time.<sup>14</sup>

Third, there is a paper, 'Planning and Competitive Order', which is not dated, but which I would judge to stem from much the same period.<sup>15</sup> Within it, Hayek poses directly the question of how to distinguish between those kinds of governmental action which are compatible with a free economic system, and those which will lead to a planned economy, and answers the question in terms of the rule of law. He mentions that this may well only be an ideal that we can approach, rather than something that can be fully realized. When discussing its characteristics, he writes of government as laying down rules of behaviour, enforcing them, and also being limited by them itself. The rules would apply equally to all people, and they are also intended to remain the same, over long periods.

It is obvious enough how all this relates to Hayek's subsequent concern with the development of the ideal of the rule of law in his *Political Ideal of the Rule of Law* (Hayek, 1955), and, further, to his discussion of the rule of law in *The Constitution of Liberty* (Hayek, 1960). What is worth spelling out, is that the ideal of the rule of law turns out to play a remarkable role in Hayek's work after *The Road to Serfdom*. For, at once, it serves two functions. On the one side, it offers a clear-cut answer to Keynes, in that, as Hayek's account develops, it is by reference to the ideal of the rule of law (interpreted in the light of *Rechtsstaat* ideas), that he offers a demarcation between those kinds of governmental activity that are permissible (although not necessarily wise), and those that are not. On the other, it turns out also to be just what is required by Hayek's account of individual liberty, too. For as he develops this in *The Constitution of Liberty*, it turns out that freedom, for Hayek, is preserved, if people are faced with laws which are universal in their form. Indeed, the reader might well think that this is all too good to be true. I would share his suspicions.

First, while I am not in a position to undertake such an analysis in the present paper, there would seem to be reason for suspicion as to whether the agenda for governmental action as set out in *The Road to Serfdom* can, in fact, be undertaken within the compass of the rule of law as set out in Hayek's later writings. My reason for not addressing this issue here, is that it would require a detailed analysis of Hayek's extensive proposals for how policy issues are to be addressed in *The Constitution of Liberty*, and a comparison of the results with the ideas about governmental action, as set out in *The Road to Serfdom*.<sup>16</sup>

My reason for suspicion is that, as I have suggested earlier, the agenda for action that Hayek set out in *The Road to Serfdom* related to his economic ideas about the character and functioning of a market-based economy, and to what was compatible and what was incompatible with these. And while there are, indeed, close relations between Hayek's economic and political ideas - this is why his ideas are in some ways so interesting - there would seem no reason to believe, *prima facie*, that there should be such a close link that the ideas developed on the basis of his economic analysis should all turn out to be compatible with his ideas about the rule of law.

Second, it seems to me that Hayek himself eventually came to have some misgivings about the views about this synthesis that he set out in *The Constitution of Liberty*. With regard to liberty, Hayek, in *Law Legislation and Liberty* (Hayek, 1973-79), in effect accepted arguments that had been offered earlier by Hamowy (1961) and by Watkins (1961), that the formalism of his earlier approach to liberty was defective. While, under the impact of Leoni, and influenced by an 'evolutionary' line of thought which became more pronounced with the passing of time, Hayek seems (at least at times) to turn his back not just upon legislatures, but



on the programme of the critical re-shaping of inherited institutions upon which he had earlier been so insistent in *The Road to Serfdom* (see, for discussion, Shearmur 1996a).

I will not, at this point, pursue Hayek any further into the ideas of his old age. Instead, I will turn back to Hayek and Keynes, and to some of the differences between their views of government.

## 5. Hayek, Keynes and 'Governmentality'

In the course of his 'Governmental Rationality: An Introduction' (Gordon, 1991), which offers an introduction to Foucault's ideas about 'governmentality', Colin Gordon comments upon a distinction, which can be found within early liberalism, between the approaches of Adam Smith and of Sir James Steuart. Steuart, he comments (drawing on Hirschman, 1977), compares a modern economy to the mechanism of a watch which is upset if it is handled by other than the most delicate hand, but which, at the same time, stands in need of frequent corrective moves by an expert 'statesman'. Smith, by way of contrast, is depicted as concerned more with setting limits on governmental ineptitude. In the light of recent work by authors as otherwise diverse as Winch (1978) and Haakonsen (1981) which have stressed the roles played by politics and the 'statesman' in Smith, the distinction is perhaps overdrawn (although compare the final section of Shearmur, 1996c for some reservations). But if one thinks back to the approaches of Keynes and of Hayek, it would seem to me that there is something suggestive about it.

For, seen in this light, there is a real difference between the interpretations of liberalism offered by Keynes and by Hayek - at least, after Hayek's *Road to Serfdom*. They are both liberals, both in respect of values (although there are differences with respect to how they interpret these<sup>17</sup>), and also in terms of their espousal of a market-based form of social organization. Further, as Gamble has argued, Keynes can, on occasion, even be found voicing arguments drawn from Burke.<sup>18</sup> But there is, nevertheless, a significant difference between them. For Keynes, liberalism depends upon the discretionary intervention of an elite, armed with theoretical knowledge; while Hayek's vision of liberalism becomes one of individual action which can take place freely, under general laws by which the government itself is also bound. It is in the context of his interpretation of liberalism that, as I have already suggested, Keynes interprets the message of Hayek's *Road to Serfdom*; namely, as supplying an important warning, that should be kept in the back of their minds by the elite who are playing an activist role within a Keynesian liberalism.

But what of Hayek? As I have suggested, as Hayek's views develop over time, he places increasing stress upon the rule of law as giving a form within which governmental action should take place. Just as in Keynes, there is theoretically-informed intervention - both in the construction and the improvement of a constitutional and legal framework, and in policy measures within it. But formal limits are placed upon all this, which relate to Hayek's analysis of individual freedom. All this, however, seems to me to lead to two problems relating to his work.

The first is that, as we have seen, in *The Road to Serfdom*, Hayek allows government a fairly extensive agenda; further, his key concern there would seem to be simply that, when government is acting in order to do the kinds of things that he favours, it does not act so as to foul up the workings of a market-based social order which Hayek thinks so important for people's well-being and also for their liberty. The key problem, however, is whether government can, in fact, accomplish what Hayek wishes it to do in *The Road to Serfdom*, while limited to actions undertaken in accordance with the rule of law as he subsequently interprets it. As I have explained, I am not in a position to examine this issue in detail in the present paper. But it would seem to me that this is, in effect, the agenda of the discussion of

policy issues in his *Constitution of Liberty*; although, as I have indicated, he changes his position yet again, in his subsequent writings. This work is impressive, but it would seem to me that in it - and with the passage of time - Hayek becomes less interventionist than he is in *The Road to Serfdom*.<sup>19</sup> And indeed, a key problem that faces someone attracted to the argument of *The Road to Serfdom* is: can government in fact accomplish what Hayek there wishes that it should do, if it is limited to acting on the basis of general rules? It is striking, in this context, to recall that Hayek in *The Road to Serfdom* referred to the way in which the effects of the actions of a state, limited to acting on the basis of general rules, would be unpredictable (Hayek, 1944, p. 76). But, at least on the face of it, some of the kinds of action to provide specific services, which he envisages the state as undertaking in that very book, would require its acting in ways that *can* be predicted, in detail.

Hayek's attachment to the rule of law would seem also to pose some more general problems for his approach. Hayek's work is distinctive among those who come to political thought from a background in economics, in treating people as acting on the basis of specific rules and habits, rather than for addressing the actions of 'rational economic man'. This leads him - as in 'Individualism: True and False' - into a kind of cultural conservatism. But clearly, insofar as what Hayek has dubbed 'false individualism' becomes influential - which is one of his worries - there is a problem. For one consequence of his approach, is that his view of liberalism seems to require people with particular characters, as its starting point. And if one is led to agree with Hobbes that: 'Man is not fitted for society by nature, but by discipline'.<sup>20</sup> this poses a problem for a Hayekian approach as to whether government can have any legitimate role in the creation or even the maintenance of the characters needed for liberalism, on the part of those people who live within liberal regimes.

The second problem relates to the connection between Hayek's argument and the actual processes of action on the part of the state. What government should do, for Hayek, needs to be informed by *his theories*. What Hayek offers in *The Road to Serfdom* is an argument about the character of a desirable social order. It is theoretical in its character, and it is, as it were, pitched to a benevolent despot who would be moved to action by truths about what is in the public interest, and who is, in effect, assumed to act upon the truths that are to be found, relating to such matters. This leads to three difficulties. First, as I have already argued, it is not clear why these specific requirements should necessarily be compatible with the requirements of the rule of law. The second of these, to which I have also already referred, was pressed upon Hayek by Leoni (Shearmur, 1996a), and could subsequently be reinforced by considerations drawn from public choice theory. It is that it is not clear that government, when seen as consisting of real-life legislatures, to say nothing of the impact upon them of various interacting bodies of people with specific, and sometimes highly self-interested, motivation, can be depended upon to act as Hayek would have it do. There is a sense in which a philosopher-king, or a benevolent despot, might at least be able to listen to, and to appreciate, Hayek's argument; whereas it is not clear how it can even be addressed to the diverse figures involved in the actual policy-making process within liberal democracies. (We must here bear in mind that it is also the actual political process that would be responsible for the legislation that Hayek commends to us when, in his work, he discusses the ideal of the rule of law.)

Third, Hayek himself, in his later writings, responds to these very problems about the political process by suggesting a revision of our political institutions and, in the end, by proposing that there should be a division between an upper and a lower chamber, both elected, but one imposing rules under which the other operates (Hayek, 1973-79, volume 3). While some of the details of Hayek's account are a little strange, and while one may have some doubts about the practicability of any such arrangements, the overall thrust is clear enough. For it offers us a model in which the rules under which government in the more regular sense

operates, are set by a democratic body which stands outside of the political process, as ordinarily conceived, and which lays down general rules with which the conduct of government must then comply. (One has here, as in some other ways - not least their legal formalism and its supposed link with freedom - an interesting parallel between Hayek and the Rousseau of the *Social Contract*.) One key problem about Hayek's approach, however, would seem to be that there is no reason why the general rules to which an elected body would agree, would be informed by the theoretical ideas of Hayek's liberalism.

Indeed, to sum all this up, there seems room for scepticism about the way in which Hayek's ideas developed after *The Road to Serfdom*. For while it is understandable that he found attractive a view which seemed to resolve the problem of the agenda and non-agenda of governmental action, and the problem of individual freedom, in one single move relating to the ideal of the rule of law as set out in the *Rechtsstaat* tradition, it is not clear that such a government could in fact accomplish what Hayek himself would require of it.

What, then, is to be done? The first issue that needs to be addressed, is the charge of 'elitism' that was leveled against both Keynes and Hayek by Gamble. In this connection, Gamble quotes Keynes as follows (Gamble, 1996, p. 157, quoting Keynes, 1972, p. 295):

I believe that in the future, more than ever, questions about the economic framework of society will be far and away the most important of political issues. I believe that the right solution will involve intellectual and scientific elements which must be above the heads of the vast mass of more or less illiterate voters.

Now, Keynes here puts things bluntly; and it is surely possible to modify his views, in the light of a recognition of the fallibility of human knowledge, by saying that, in principle, the judgments of experts should be open to criticism by anyone (compare Shearmur, 1996b). But be this as it may, both Keynes and Hayek offer arguments to the effect that there are considerations which pertain to those arrangements which will best secure human well-being and freedom, which cannot, realistically, be made transparent to the understanding of all citizens. It is not enough merely to deplore their elitism, as does Gamble; rather, in order to criticize them, one needs to meet their argument. I am sceptical as to whether this could be done.

What conclusion should, then, be drawn from the argument of this paper? Is it that, in the end, it was Keynes rather than Hayek who was right, and that when Gamble indicates that Hayek was more of a democrat than was Keynes, it was Keynes who got the better of the argument? To this I wish to respond, although my personal interest is not so much in democracy as in individual liberty. I think that ideas about the significance of criticism in a public forum, and the discursive redeemability of our factual, normative and aesthetic claims are important. I also think that there are advantages to being able to get rid of governments by votes rather than by force, and that insofar as we have to make collective decisions, it is best done by voting. But, personally, my preference is for forms of social and political order which limit to the greatest possible extent the need for collective decisions (for example, by restricting these to minimal 'rules of the game', thus allowing people, within them, to make what choices they wish). Such ideals, however, would seem also to be hit by Keynes' argument. How is the libertarian to respond to the argument that, without Keynes and his ilk ruling over them, or Hayek and his ilk, they cannot enjoy the benefits of a liberal social order?

In my view, there is no necessary incompatibility between liberty, and the rule of an elite (subject, say, to 'Popperian' critical constraints). There is, further, no necessary incompatibility between liberty and discretionary governmental action, or, even, with government's shaping our characters by means of various disciplines, so as to produce the

kind of order within which we wish to live. For such 'government' may, itself, be a matter of *individual choice*, in the sense that it may be seen as the product not of majority voting, or of the interplay of interest groups within a pluralistic regime, but, instead, as something the character of which we can *each* choose, on a voluntary basis.

Indeed, as I have argued in my *Hayek and After*, I think that Hayek's ideas about an interventionist government within a *Rechtsstaat* - to say nothing of his later ideas about new constitutional arrangements - were not, in the end, a fruitful way of developing his insights. Rather, not only may 'Keynesian' - in the sense of elitist and discretionary, rather than of his specific economic theories - elements with regard to the activities of government well be required if liberal regimes are to flourish, but regimes allowing for the use of these, or a regime dependent on at times abstruse theoretical ideas (as would be Hayek's), can only be combined with individual liberty if their activities are seen not as those of government in the regular sense, but as those of something the membership of which an individual can choose from within a *minimalist* governmental structure. All told, it thus seems to me that the problem of the state opened up by Hayek's work, and by Keynes' comments upon it, is best answered by ideas similar to those to be found in the 'utopia' section of Robert Nozick's *Anarchy, State and Utopia* (Nozick, 1974). It is a minimal state - but one which offers the possibility of voluntary choices, within it, for something more substantive, including, if people find the prospect attractive, rule by a Keynesian or a Hayekian elite - which seems to me to offer the best prospects for the flourishing of a Hayekian liberalism.

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## Notes

- 1 Although I should stress that as I have no specific evidence that Hayek was motivated, in what I suggest to be these changes in his views, by a wish specifically to respond to Keynes' letter, I would not wish to claim that I can show that it played a causal role in the development of Hayek's thought. At the same time, it does seem to me that these changes do offer a specific answer to the question that was put by Keynes to Hayek, as distinct, for example, from requests that were put to him by others to say more about his own more positive views. (Bruce Caldwell, whose queries have prompted me to spell this out, refers in the latter connection to a review by H. D. Dickinson of (Hayek, 1939).)
- 2 It is, though, striking that Durbin, while a socialist, continued to work within a Hayekian research program in respect of his ideas on the theory of capital and the trade cycle.
- 3 There are two unpublished essays in the Hayek Archive at the Hoover Institution on the theme of the character of Nazi Germany. Hayek also tells us that he wrote a memo on this general theme for Beveridge, the Director of the L.S.E. (see 'The Economics of the 1930s as seen from London', in Hayek (1995), p. 62). Hayek then published an article (Hayek, 1938), which was subsequently expanded into a pamphlet (Hayek, 1939), and which was, in turn, expanded as (Hayek, 1945).
- 4 Hayek comments on the contrast between his view of National Socialism and that of some of his colleagues at the L.S.E. in the following terms. 'They... tended to interpret the National Socialist regime of Hitler as a sort of capitalist reaction to the socialist tendencies of the immediate post-war period, while I saw it rather as the victory of a sort of lower-middle-class socialism...'. See 'The Economics of the 1930s as seen from London' in (Hayek, 1995), p. 62.
- 5 This would not be the appropriate place to discuss the merits of Hayek's ideas on this score; but whatever the pros and cons of his approach, he was at least attempting what would be required of a

theory of totalitarianism; namely, trying to explain why regimes which, prima facie, would seem to be the antithesis of one another nevertheless had certain key characteristics in common. It seems to me a mark of the quality of much work on this theme within political science, that approaches like that of Hayek were ignored, while, instead, people seemed satisfied with putting forward what amounted to little more than classificatory schemas and lists of features that the different regimes were supposed to have in common - as if these constituted an explanatory theory.

- 6 On the distinction, compare Karl Popper's 'Prediction and Prophecy in the Social Sciences', in (Popper, 1963).
- 7 See, on this, his 'Foreword' to the republication of the American edition of *The Road to Serfdom* (Hayek, 1956), also published as 'The Road to Serfdom after Twelve Years', in (Hayek, 1967). Compare also Hayek to Durbin 17/2/48 (Durbin 3/10, L.S.E. archives) in which Hayek comments that what has taken place in the last three years has exceeded his worst apprehensions, and, for his most detailed argument, the first section of his (incomplete) 'Postscript to The Road to Serfdom (1948)' in the Hayek Archive in the Hoover Institution Archive. (Box 93, accession number 86002-8M.40; the material is included in the brown folder inscribed 'Road to Serfdom'. N.B. this is among the Hayek material that has not yet been processed, and so does not have a regular Hoover Archive identification.) Hayek drew on some of the material from this projected Postscript, in writing his foreword to the (new) American edition.
- 8 See Hayek, 'Postscript to The Road to Serfdom (1948)', pp. 11-12. In response to a query from Bruce Caldwell, I should stress that the word 'active' in the text is mine; but I would wish to suggest that it is justified by Hayek's argument, which is that the existing monetary and credit mechanism contains disequilibrating forces which ought, Hayek suggests, to be counteracted by a sensible monetary policy. We will note later that Hayek in this Postscript also emphasises that he wants this policy to be guided by known rules.
- 9 See, for a particularly clear statement of this, the transcription of a radio discussion of *The Road to Serfdom*, in (Hayek, 1994, p. 112).
- 10 Archives, British Library of Economic and Political Science, Misc. 600. Keynes to Hayek, April 4, 1944. N. B. Unpublished writings of J. M. Keynes copyright The Provost and Scholars of King's College, Cambridge, 1997.
- 11 See 'The Road to Serfdom', Address Before the Economic Club of Detroit, April 23, 1945. Hayek Archives, Hoover Institution, Box 94, [folder 38]; see pp. 6-7. (This is among the material has not yet been processed and so does have not a standardized archive location.) The paper is a transcript of Hayek's talk taken by a shorthand reporter.
- 12 'Postscript to The Road to Serfdom (1948)', pp. 12-13.
- 13 Hayek Archive, Hoover Institution, Box 94, folder 46. (Again, this is among the 'not yet processed' material in the Archive.)
- 14 Those interested in the development of Hayek's work might note that this suggests that Hayek was at this early stage already open to the argument that Leoni was later to press against his preference for legislation (i.e. that the problem with legislatures was that they as a matter of fact could not be depended upon to leave such things alone and thus to provide stability); a development which in turn led to the change of Hayek's legal views in *Law, Legislation and Liberty* (Hayek 1973-79). (See for discussion of the impact of Leoni (Shearmur, 1996a).)
- 15 'Planning and Competitive Order', Hayek Archive, Hoover Institution, Box 108; the folder in which this is held is labeled 'Planning and Competitive Order'; it is again among the unprocessed material. In the first section of the lecture, Hayek explains that this was the first of three lectures, the second of which dealt with why in a planned economy the rule of law could not be preserved, while the third lecture would be concerned with the planning of a legal order such that, within it, the free decisions of individuals would contribute as much as possible to the welfare of the society as a whole. (At the same time, the second and third sections of the paper themselves deal briefly with the topics announced for the other lectures, so it is difficult, without more information than is currently available to me, to judge whether we may not, here, have some version of the text of all three lectures.)
- 16 At the same time, it seems to me important that one identifies what Hayek's problematic actually was; something concerning which one needs to note changes over time. The dangers of not doing so are, I believe, illustrated by Kley's recent *Hayek's Social and Political Thought* (Kley, 1994). This, while discussing Hayek's ideas in some detail, seems to me to misunderstand what Hayek was attempting to do, because it tries to relate his ideas about government to general notions about spontaneous order, rather than to the specific agenda which he was setting himself, and its transformations over time of the kind which I have discussed here.
- 17 On this, Hayek, in his 'Individualism: True and False', in his *Individualism and Economic Order* (Hayek, 1948), and in his 'Three Sources of Human Values' (available, for example, as the Appendix to

- volume three of (Hayek 1973-79)), would seem to me to protest too much, in that the role of traditional morality, for him, is functional rather than something of intrinsic significance. It is not clear that his view that we should take an uncritical attitude towards it is adequate, given that it also contains elements which, as Hayek elsewhere admits, are hostile to a liberal market order.
- 18 (Gamble, 1996, p. 159). Gamble's case is perhaps weakened by the fact that the material that he quotes is an argument for a focus on the short run.
- 19 Bruce Caldwell has drawn my attention to the fact that Hayek himself, in his 1976 Preface to a new edition of *The Road to Serfdom*, says that when he wrote the original book, he 'had not wholly freed [himself] from all the [then] current interventionist superstitions, and in consequence made concessions that [he] now think[s] unwarranted' (Hayek, 1976, p. xxi).
- 20 Thomas Hobbes, *De Cive*, 1.1; quoted by Gordon (1991), p. 14.

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