EIGHT QUESTIONS ON THE ARCHITECTS OF CAPITALISM

1) It seems that whenever capitalism lurches toward recession, depression, or serious financial crisis, Keynes makes a re-appearance in public policy circles and in the press. And yet, within a year or two, he has been pushed off stage again. Can this cyclical, temporary importance last forever? Is the public fear of economic disaster enough to keep his work in play? Or is Keynes doomed to fade away as capitalism returns (again and again) to good health? ---------- 5

2) Hayek argues strongly that only markets have the ability to transmit information about what people actually want, and hence that prices are central to any effective economic system. Is he right as regards the prices of stocks and bonds? Are the market prices for stocks and bonds an effective representation of the "real" value of these assets? ---- 8

3) The instability created by financial markets is a very central reality in contemporary capitalism. Which of our two architects gives us the best way to understand the instability created by financial markets? ---------- 12

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5) Is capitalism too dynamic for philosophical reflection? By the time philosophers figure out what they want to say about capitalism, hasn't it become something else altogether? ---------- 18

6) Perhaps the most notorious feature of capitalism at the beginning of the 21st century is the large inequality of income that it is generating. Is this inequality compatible with Hayek's vision of a market society? ---------- 20

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1) **It seems that whenever capitalism lurches toward recession, depression, or serious financial crisis, Keynes makes a re-appearance in public policy circles and in the press. And yet, within a year or two, he has been pushed off stage again. Can this cyclical, temporary importance last forever? Is the public fear of economic disaster enough to keep his work in play? Or is Keynes doomed to fade away as capitalism returns (again and again) to good health?**

Roger E. Backhouse: Such a general question is possibly an unanswerable question because the answer must depend on so many factors. I approach this from the perspective of the UK, where much of the press is controlled by people who have a vested interest in measures that benefit the rich, and harbour scepticism about what might be called social democracy. If this situation were to change, who knows what might be possible. There is also the role played by social media, which is probably even more complicated.

Bruce Caldwell: Keynes's ideas provide cover to politicians who wish to run deficits, so he will never go out of style! Unfortunately often after the economy returns to health the deficits do not disappear, thus requiring still larger deficits during the next crisis. This

was not of course Keynes's intent and indeed his actual message in his writings differs from his later "Keynesian" followers. But it does seem to be a part of their legacy.

Ivan Mikloš: I think that if Keynes and Hayek were still alive today, both of them would consider the current situation to be a problem, but each for different reasons and with varying intensity. Keynes would probably not see it as a fundamental problem, while Hayek would. In other words, while Keynes might view the state of today's capitalism as a quantitative problem, Hayek would definitely argue that it is a much deeper, and not only a quantitative but also a qualitative (systemic) problem.

Hayek argues that the problem is systemic and involves fiat money (money not backed by anything) and the existence of central banks, which are essentially government institutions that manipulate not just the quantity, but also the price of the most important market commodity: money. They issue an excessive amount of unbacked money, as well as determine its price, namely the basic interest rate. The quantity and price of the most crucial market commodity (money) are administratively determined, much like most prices in centrally-planned economies. This leads to high inflation, high deficits and debts, crises and recessions, a debt-driven model of economic development and growth (where debt grows faster than the economy). According to Hayek, it ultimately never ends well. And this is not just from an economic perspective, but also in terms of the loss of freedom.

The problem is that we will never actually know whether the system would work better or how it would actually work and look if fiat money and central banks had never been created and the market determined the price of money. Today's system is so widespread and ubiquitous that hardly anyone relevant is proposing the abolition of fiat money and central banks, and few can even imagine it.

Keynes would certainly have nothing fundamentally against today's financial and monetary system, but the policymakers (i.e. politicians and the economists who advise them) would certainly be criticised for adopting only half of his theory while ignoring the other half, and even acting in direct contradiction to it. Keynes supports aggregate demand management (i.e. increasing deficits and debts) during times of crisis, but he also says that during economic revival policymakers should create reserves for such counter-cyclical, expansionary fiscal and monetary policy. In good times, there should be budget surpluses. However, in most capitalist countries, aggregate demand is supported not just in bad times, but in good times as well, and savings only occur when there is no other choice (usually under the threat of default).

Scott W. Scheall: Rather than "capitalism" – an ill-defined term, if ever there was one – I prefer to speak of *markets, market economies*, and *market societies*. Unlike "capitalism," the latter terms imply that such entities always exist in broader social environments that include, importantly, governments and other, non-market, civil institutions. It is an open question whether market economies ever lurch "toward recession, depression, or serious financial crisis" without receiving a prior push from government action. It was certainly Hayek's position that, when the price system is permitted to operate freely, when its functions are not manipulated by exogenous, typically governmental, forces, market economies tend toward equilibrium.

In any case, there is nothing general about Keynes's *General Theory*. It is a theory of (what non-Keynesian economists would call) *disequilibria*. It is only relevant, if at all, during times of recession, depression, etc.

Toshiaki Hirai: Influenced by the theory and policies of Keynes's General Theory, various "Keynesian Schools" advocating a new theoretical and policy framework have emerged to deal with new economic problems since the end of WWII. To take a few examples, "the Income-Expenditure Keynesian School" (J. Hicks, D. Patinkin, J. Tobin), "the Disequilibrium Economic Keynesian School" (R. Clower, A. Leijonhufvud), "the Post-Keynesian School" (P. Davidson, H. Minsky) and "the New Keynesian School" (N. Mankiw, J. Stiglitz, M. Woodford).

This phenomenon means that the various Keynesian schools have developed different theories and economic policies, criticizing other schools. It could even be said that disputes have occurred within the same school (one famous example is the dispute at the Post-Keynesian Summer School held in Trieste, Italy, in the 1980s).

Considering the above, if we answer Question 1, it is fair to say that the phenomenon mentioned occurs mainly in the field of mass media. On the other hand, in the field of academia and policymakers, there are various "Keynesian Schools" based on the abovementioned development. In that sense, it can be said that Keynes's influence has continued for a long time.

(We might add that Anti-Keynesian Schools have been popular at some point in time, such as "Monetarism" and "the New Classical Economics School.")

Heinz D. Kurz: I wonder whether your description of the cyclical return of Keynes's economic analysis is fully correct, because the latter contains elements that play a role also in discussions above and beyond his views on the cause of recessions or depressions and how to fight them. See especially his social philosophy, which revolves, inter alia, around the problem of excessive inequalities of incomes and wealth (*General Theory*, chap. 24) and, to put it pathetically, the meaning of life; but see also his theory of liquidity preference or the renewed interest in the theory of the multiplier. In his social philosophy Keynes insisted that many people feel the desire to do something with their lives in addition to consuming goods and having leisure. As Edmund Phelps put it not long ago: In conventional mainstream economics today, "The economy is mechanical, robotic. The crops may be growing, but there is no personal growth."

Be that as it may, the dream of the "Great Moderation" – an economy that grows steadily and smoothly – has turned out to be just another bubble that burst with a loud bang. It confirms the view of Joseph A. Schumpeter: "Cycles are not, like tonsils, separable things that might be treated by themselves, but are, like the beat of the heart, of the essence of the organism that displays them." However, if capitalism is bound to proceed in leaps and bounds, booms and busts, phases of overheating, followed by recessions or depressions, then Keynes's concern with the causes and remedies of economic downturns and failures of effective aggregate demand can be expected to get into the limelight time and again, and for good reasons. Richard Posner of the University of Chicago, himself in the past a fervent advocate of the Chicago School of Macroeconomics and the Financial Markets Efficiency Doctrine, with a view to the financial crisis of 2008 rejected vehemently Gregory Mankiw's 1992-view that Keynes's *General Theory* "is an outdated book". Not true, insisted Posner: "We have learned since September [2008] that the present generation of economists has not figured out how the economy works." Re-reading *The General Theory* is said to have provided him with illuminating insights that significantly improved his understanding of the crisis, which contemporary theory did not. Ironically, in Posner's view, more than 70 years of

additional "progress" in macroeconomics has actually led to regress! Numerous other economists expressed similar views. There is some sad element of truth in Posner's 2009 dictum that *The General Theory* "despite its antiquity, is the best guide we have to the crisis". Apparently large parts of the economics profession fell victim to supply-side, rational-choice, rational-expectations, efficient-market, real-business- cycle theories – a case of intellectual capture, contagion and herd behaviour. The bubble was bound to burst one day, with disastrous effects on the economy and society.

Hansjörg Klausinger: Apparently, there are many sources of crises and depressions, put in the simplest terms (aggregate) supply shocks and demand shocks. Keynesian remedies are effective if (and only if) applied in the case of demand shocks, that is, when the cause of the crisis is a general deficiency of demand. They will not help with supply shocks where some structural adjustment is called for, which can be best accomplished by the working of the price system and by maintaining monetary stability. (Compare, e.g., the Great Depression with the oil crises and "stagflation" of the 1970s.) Even with regard to demand shocks, after Keynesian remedies have successfully combated the short-run symptoms, readjustments may be required for eliminating the persistent structural causes of crises. In this sense, Keynes probably becomes fashionable with every new crisis, yet Keynesian policies are not the appropriate cure in every instance.

2) **Hayek argues strongly that only markets have the ability to transmit information about what people actually want, and hence that prices are central to any effective economic system. Is he right as regards the prices of stocks and bonds? Are the market prices for stocks and bonds an effective representation of the "real" value of these assets?**

Backhouse: The answer to the first of these two questions is clearly "Yes": there is no substitute for prices in order to provide the information necessary for allocating resources efficiently. I am not qualified to answer the second question, which is an empirical one, the answer to which may be different in different times and places. However I have spent a lot of time studying the work of Paul Samuelson. He consistently argued that financial markets were generally efficient at the micro level but not at the macro level. In other words, he believed they do a reasonable (though not perfect) job at pricing individual stocks relative to each other, but that they are unreliable in determining the overall market valuation.

Caldwell: Hayek was thinking principally about product and labour markets, not those for financial assets, when he wrote about the important role played by freely adjusting prices in coordinating economic activity in a world of dispersed and subjectively-held knowledge. Hayek and other Austrians were subjectivists, so the notion that there is some "real" price independent of the market price would be anathema to them.

Robert Skidelsky: This would be hard to maintain in the light of the crash of 2008. Remember Alan Greenspan's explanation of the 2008 collapse as "underpricing of risk worldwide". (Greenspan: *The Age of Turbulence*, p. 507).

Mikloš: Hayek would have said that the real and objective price (including the price of stocks and bonds) would be determined by the market, if it were not distorted by fiat money and manipulated in terms of quantity and price by the central bank. Therefore, Hayek would definitely not consider today's stock and bond prices to be objective, but rather inflated.

Peter Boettke: This is a very complicated question because one could write an entire treatise in addressing this issue. Vernon Smith in his experiments has shown that asset values can deviate significantly from true underlying values. But the question is why? And what feedback loop is in operation? These questions are built upon a further elaboration of Hayek's price theory, which takes some disentangling from neoclassical presentations and interpretations. In my book, *F. A. Hayek: Economics, Political Economy and Social Philosophy* (2018, pp. 77-118) I attempt to do that; how successful is for others to judge. But critical to the argument I develop there and elsewhere throughout that book is what I call Hayek's *epistemic institutionalism*. His theory of the price system is one of social epistemics, and focuses as such not only on learning, but also adaptation and adjustment based on the learning in the market context.

Scheall: This is a mischaracterization of Hayek's view about the epistemic – knowledge-coordinating – aspects of prices.

First, Hayek's thesis about the epistemic properties of prices was a *necessity*, not a *sufficiency*, claim. He claimed that markets have the ability to transmit knowledge, not that *only* markets have this ability. He was quite explicit that economic agents need other bits of (scientific, cultural, personal, etc.) knowledge in order to coordinate their activities with other agents.

Second, he argued that the effectiveness of the epistemic properties of prices depends on the degree to which prices are not exogenously manipulated by, say, central banks (with regard to interest rates, the most important prices in a market economy, according to Hayek), government regulators, or corporate monopolies. Manipulated prices do not possess the knowledge-coordinating properties that Hayek attributed to unmanipulated prices. Indeed, manipulated prices tend to promote *discoordination*, according to Hayek.

Given that market prices for stocks and bonds are subject to a considerable degree of exogenous manipulation, primarily through the interest-rate setting activities of central banks, the notion that Hayek would have thought the prices of stocks and bonds to reflect some underlying "real" value is preposterous.

Hirai: It can be said that Hayek grasps the nature of the market society in three frameworks ―economic agents with "on-site knowledge," "the price system" with an information propagation function, and "competition" that functions as a driver of "unforeseen change". As far as these points are concerned, His view of the market society is realistic.

On the other hand, the market society is conceptually constructed, with essential aspects of the "real" market society, such as the massive growth of Co., Ltd. and the increasing role of the state, having been abstracted. In this respect, Hayek's view of the market society is an idealistic image, extracted as "pure."

Hayek regards the market society grasped this way as a representative example of "the spontaneous order" and defends it from this stance.

Thus, Hayek's theory of market society is suspended "between realism and idealism".

In *Prices and Production*, Hayek argues that economic fluctuations are caused by changes in the production structure which occur by changes in relative prices.

However, it is unclear how he views the prices of stocks and bonds, for he does not explicitly explain the movement of those prices in his economic theory.

Robert W. Dimand: Hayek, in the essays collected in *Individualism and the Economic Order*, does make a forceful case for the role of market prices in transmitting information about the goods and services that people want but, as pointed out by Abba Lerner, Oskar Lange and other market socialists in the social calculation debate of the 1930s, that argument does not depend on whether the enterprises trading in those markets are owned by private investors or whether their shareholders are pension funds, sovereign wealth funds or governments. The argument that goes beyond that one, associated even more with Schumpeter than with Hayek, is that only ownership of enterprises by wealth-seeking individuals provides the incentive for innovation, for the discovery and introduction of new processes and products. As Schumpeter stressed, this process of creative destruction both creates wealth and destroys the value of some existing physical and human capital. If the new wealth created is large enough that, at least if costless redistribution was possible, the winners could fully compensate the losers and still come out ahead, that is no solace to the losers unless full compensation is actually paid.

Does Hayek's view of the informational role of market prices apply to the prices of stocks and bonds? "Are the market prices for stocks and bonds an effective representation of the 'real' value of these assets?" Prices of financial assets are subject to bubbles and excess volatility that persist for long periods of time, in a way that prices of goods and services are not. Value investing, expecting asset prices to eventually conform to underlying "fundamental" values as expounded and practiced by Benjamin Graham and Warren Buffett, has a good record in the very long run but over quite long periods of time financial markets can be dominated by the will to believe that this time is different, as described by A. C. Pigou's waves of optimism and pessimism or by Keynes's (and George Akerlof and Robert Shiller's) animal spirits. Cryptocurrencies, which reached a market value exceeding three trillion dollars, seem to exemplify such a triumph of the will to believe. Bubbles eventually burst but, unless there is some basis for predicting when they will burst, betting against a bubble may not be rational – there is a longstanding adage among traders that the market can stay irrational longer than you can remain solvent. The short sellers celebrated by Michael Lewis in *The Big Short* were not only insightful about the shaky foundations of the bubble in asset-backed securities and subprime mortgages: they were lucky about when the bubble imploded. Hyman Minsky's theory of endogenous financial fragility, appropriately presented in his book *John Maynard Keynes* (Columbia University Press, 1975) and drawing inspiration from Chapter 19 of Keynes's *General Theory* and from Irving Fisher's debt-deflation theory of great depressions, captures a crucial aspect of financial markets missed by Hayek.

Kurz: Prices are, of course, extremely important in a private-decentralized market economy, but it is not true that only markets have the ability to transmit information. (I am just transmitting information (as opposed to truth!) to the readers of this interview and there is no market between sender and receiver.) And if markets (e.g. for financial assets or currencies or tulips or whatever) are repeatedly generating bubbles from within, the information they transmit may give rise to "wrong" incentives, followed by "wrong"

decisions that culminate in crises rather than "effective economic systems". From this, it follows that one ought to receive with the utmost suspicion the claim that the market prices for stocks and bonds involve "an effective representation of the 'real' value of these assets". First, to begin with you would have to specify and explain, how the "real" value of the assets under consideration can be ascertained *independently* of what is actually going on the respective markets. To claim that actual prices already reflect "real" or "fair" values is a tautological statement and therefore useless unless "real" or "fair" values are defined separately from market values. It is only then that you could decide whether or not *at a given moment of time* market values are close to "real" values and whether *over time* the former oscillate around or gravitate towards the latter. The classical political economists, from Adam Smith to David Ricardo, had discussed such a problem with regard to the prices of commodities and had sagely provided a definition of "natural prices" independently of "market prices" in their illuminating analysis of the "gravitation" of the former towards or their "oscillation" around the latter.

Interestingly, the then leading American marginalist author, Irving Fisher, claimed the day before Black Thursday in 1929 that everything was fine and that stock market prices reflected the solidity of the situation. He apparently confounded actual values with "real" ones. Keynes knew better. One is again reminded of his pungent statement: "Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done." How right he was!

I am not aware of anything written by Hayek that is of comparable importance in the present context. His explanation of the World Depression in *Prices and Production*, published in 1931, is at best peculiar. In his view the villain of the story was the banking system, which "arbitrarily" at first reduced the money rate of interest below the "equilibrium" level and made producers reduce consumption goods output in order to transfer productive resources to investment industries, etc., etc. Hence in Hayek's view the Great Depression was essentially the result of a choice of technique problem. Leading economists, including Schumpeter, received this view with astonishment and disbelief. And, as Sraffa showed convincingly, Hayek's reasoning was logically unsound. (Since I have widely written on this, I ask interested readers to consult my works.)

In short: I don't think that Hayek was right or is especially interesting in regard to the matter under consideration. (There are, however, other parts of his work I consider to be highly interesting and praiseworthy.)

Klausinger: Hayek sees the price system as a (signalling and incentive) mechanism that effectively processes the information inputs from individual agents. He does not suppose that these agents' perceptions are always correct, let alone that they exhibit perfect foresight. Therefore, even if they represent the best feasible outcome, market prices of stocks and bonds will never be perfect as an estimate of future (or fundamental) values. However, much of what goes wrong in this regard may be traced to failures in regulation and errors of policy.

3) **The instability created by financial markets is a very central reality in contemporary capitalism. Which of our two architects gives us the best way to understand the instability created by financial markets?**

Backhouse: Keynes. I am unaware that Hayek offered any analysis to rival Keynes's analysis of financial markets.

Caldwell: Both contributed their own theories, and those should be supplemented by others' theories, in my opinion. Constant innovation in financial markets and the fact that a market economy is a paradigmatic example of a complex, adaptive and emergent system ensures that no theory will be the best.

Mikloš: Understanding the causes of instability is probably better facilitated by Hayek's theory of the economic cycle. However, the problem is that when things go wrong (i.e. when a major crisis like the Great Depression of 1929-1933 or the Global Financial and Economic Crisis of 2007-2009 occurs), nobody really cares about the cause; everyone tries to put out the fire and minimise the negative impacts.

Keynesian therapy, especially expansionary monetary and fiscal policies, is more effective at extinguishing fires. Its goal is to prevent the freezing of financial markets and flows, which would lead to a much deeper and harsher recession. This is because it would wipe out not only insolvent firms, but even healthy ones with no liquid assets as well.

Boettke: I am biased no doubt, but I find the culprit of our financial instability not in the speculative behaviour of individuals but in the distortions in the signals caused by fiscal irresponsibility and monetary mischief. So again, back to my first answer, since 9/11 the US economy (it doesn't matter which party is in power) is one of growing fiscal gap (see the work of Laurence Kotlikoff) and continuous deviation from Bagehot's dictum on central bank practice. I published a book in 2021, *Money and the Rule of Law* (Cambridge) with Alex Salter and Dan Smith, which tries to provide an argument for this history of deviation from best practice and how to get back on track. So in the Keynes vs. Hayek debates, I take the side of Hayek. Though I do think Keynes (chapter 12) of course raises very important issues that economic actors must cope with in the world, and that any analysis which doesn't address the issue of radical uncertainty will be far poorer for it.

Scheall: I can only answer as above. Financial markets always exist in contexts consisting of governments, central banks and other regulatory bodies, and non-market institutions. If instability emerges from the interactions of financial markets and these other institutions, any one of – or some combination thereof – might be the causal culprit(s).

I think a better understanding of financial markets might emerge from combining the insights of both Hayek and Keynes. As is well known, Keynes was an experienced and knowledgeable investor. His analysis of investor psychology is quite perceptive. Hayek did not write extensively about (or have much personal experience in) financial markets. It is clear from his business cycle theory, however, that he thought central-bank manipulation of interest rates had deleterious consequences on investor psychology and financial markets.

Hayek was, in my opinion, the better philosopher and methodologist of social science. His insight that monocausal explanations are to be avoided in the social sciences, that social

phenomena are always complex phenomena that emerge out of many causal factors, and their interactions, must be – as I've insinuated throughout my responses here – the starting point for any adequate explanation of social phenomena, including, but not limited to, recessions, depressions, inflations, income inequality, and financial-market instability.

Starting from the need for a multi-causal explanation, some progress might be made in our understanding of financial-market instability by embedding Keynes's insights about investor psychology within a Hayekian framework according to which governmental intervention in the economy stokes the confusion of investors about the profitability of particular classes of investments.

Hirai: I think Keynes does.

Keynes emphasizes two vital points in *The General Theory* in "The General Theory of Employment" (1937), a reply to four articles focused on *The General Theory*.

One is to incorporate the reality that the future is filled with uncertainty, and the other is a presentation of the demand and supply theory of the output as a whole. The former is put forward in connection with his theory of the rate of interest and his theory of investment.

Hyman Minsky, who belongs to "the Post Keynesian School," is famous for the "Financial Instability Hypothesis." He develops the hypothesis, emphasizing Chapter 17, "The Essential Properties of Interest and Money," of *The General Theory*. He also emphasizes portfolio selection, financial condition, and instability in investment, stating that an essential liquidity preference in the capitalistic economy lies in bankers and businesspeople: it appears as the tendency of their balance sheets.

In contrast, the theory presented in Hayek's *Prices and Production*(1931) argues that money affects relative prices, which lengthens [or shortens] the production structure. It considers the impact of money on the real economy but does not address the issue of how money itself works in financial markets.

Dimand: My answer to another question requires that the answer to this question is Keynes. Hayek's *Prices and Production* (1931) provides insight into one specific source of instability in financial markets, overinvestment due to central banks keeping the interest rate too low, while Keynes's *Essays in Persuasion* (1931) and *General Theory* (Chapter 19) illuminate the phenomenon of financial instability more generally.

Kurz: This is perhaps a rhetorical question because the answer appears to be all too obvious. It suffices, first, to reiterate Posner's 2009 dictum that "the best guide we have to the crisis" is The General Theory. Secondly, it deserves to be recalled that Keynes was an investment wizard, the first bursar to King's College, Cambridge, who managed the "Chest Fund" and helped the College to accumulate a huge fortune, and who was himself on the whole a highly successful trader (partly together with Richard Kahn and Piero Sraffa). He knew financial markets in all minute details. I am not aware that Hayek can be compared to him in this regard. Third, Keynes had the most interesting things to say about the stock exchange, just recall the marvellous passage in which he compared the stock market to a "beauty contest": it is not so much important to know who is the most beautiful human being, but to know what the other members of the jury think it is. It is not the "real" value of an asset that matters, but the opinion other traders hold about it. The important point to make in this context is that Keynes was perfectly aware of the fact that in order to understand financial markets, one has to understand opinion dynamics.

A key factor in this regard is the set of opinions that people have about each other. They change those beliefs in a number of ways, by searching, by investigating, by following and imitating, and so on. This gives rise to phenomena such as contagion and herd behaviour that are not covered by conventional theories. Fourth, it is interesting to note that Hyman Minsky started from Keynes when developing his influential "financial instability hypothesis". Finally, it is worth mentioning that among the few people who somehow foresaw that a financial crisis was building up in the first decade of the twentieth century there were predominantly Keynesians on the one hand and Marxists, who were familiar with Rudolf Hilferding's Das Finanzkapital, on the other.

Klausinger: In Hayek's view the crucial source of financial instability is monetary instability due to ill-guided central banking policy. In Keynes's view expectations lack a firm base in "fundamentals" which may give rise to self-fulfilling waves of optimism or pessimism. Thus, both point to distinct but important sources of financial instability. Anyway, one may wonder to which extent financial markets would derail under conditions of monetary stability and appropriate regulatory incentives.

4) **Keynes is often seen as the architect of a capitalism that is supported by government intervention. Did the failure of governments to respond effectively to the 2008-09 financial and economic crisis prove that Keynes was naive about the possibilities of government intervention in economic life?**

Backhouse: The question presumes that governments failed to respond effectively. If that is correct, in what sense did they fail? Surely the picture is complicated, with some countries responding more effectively than others. For example, such data as I have seen suggest that the UK recovered significantly more slowly from the recession than did many other countries. To explain different responses to the crisis requires understanding the political situation in various countries, and to say that Keynes was naive in not anticipating what the political situation would be in the 21st century is ridiculous. He surely knew very well that ideal policies would not be followed. After all, he had seen the problems of the interwar period, and at Bretton Woods he was aware that he had not succeeded in getting the outcome he desired.

It is also important to remember that he sometimes said things in order to challenge people and make them think. Appearing to sound excessively optimistic can be the result not of naivete but of trying to persuade people that better outcomes are possible, if only policy makers would adopt sensible policies.

Caldwell: It is hard to blame Keynes for the 2008-2009 crisis. There were many causes of it. That said, certainly one of them was the tendency of central banks to keep interest rates too low for too long, discretionary policy that was done to keep the "great moderation" going. It ended up creating asset bubbles. None of that would have surprised Hayek.

Skidelsky: Certainly not. Keynes was not naive about the possibility of beneficial government intervention both to forestall and mitigate downturns. He did recognise that such intervention needed the support of sound economic theory. If the prevailing economic sentiment was that government intervention would only make things worse, it is not

surprising that the bond markets demanded fiscal 'austerity' as the correct response to economic downturns.

Mikloš: Keynes was not naive about the possibility of government intervention in the economy, but he was somewhat naive in assuming a higher level of responsibility on the part of politicians in two respects. First, he assumed that in good times, governments would operate with a surplus and thus create a reserve for monetary and fiscal support during bad times. Secondly, Keynes did not anticipate the significant expansion of the state.

Keynes believed it was necessary to stimulate aggregate demand (during times of crisis) to prevent the wasting of resources. In other words, he wanted the economy to utilise all available economic resources, especially labour, even during a crisis. However, in most other aspects, Keynes was quite liberal in his views. He believed that resource allocation should be primarily left to the market.

Therefore, he might not have considered today's active industrial policy as suitable or necessary.

Boettke: Keynes in my reading was innocent of what would later be dubbed public choice analysis. I do think his theory would work best if economics could be practiced from the outside-in by trained experts advising a benevolent despot. But his theories are difficult to fit into a framework of economics as practiced inside-out (we are part of the model) where the state and its actors are interested agents, and politics is about minimum winning coalitions rather than "doing the right thing" as determined by an omniscient and benevolent deity. Perhaps my biases are coming through. But to be honest, I get that there is a sort of tacit presuppositions of political economy going on. One is whether you are optimistic/pessimistic about the self-correcting mechanisms of the market, and the other is whether you are optimistic/pessimistic about the restraints on the abuse of power by the state. I happen to be optimistic about market self-regulation in the face of very difficult and ugly problems that will often take time to sort out, and I am very pessimistic about the ability to restrain the abuse of power by the state even when state action appears urgent to address an emergency. Others, I know, see the world through a different window. How to engage in respectful and meaningful dialogue across these perspectives is something that economists have had difficulty doing through the years. This is one reason why I believe it would be valuable to admit our biases to one another, rather than cloak them in the veneer of scientific objectivity. We strive to be objective no doubt, but we are guided by these various pre-scientific/pre-analytic cognitive acts.

Scheall: No. It may be that the failure of governments to effectively counter the 2008-2009 financial crisis and the "Great Recession" which followed was due to deficiencies in the design, implementation, or administration of the countercyclical policies that were enacted, rather than due to flaws in either Keynes's theory or some naivete on his part about the possibilities of effective government intervention. It may be, for example, that relevant stimulus policies were not large enough to adequately counter the shortfall in aggregate demand, as several Keynesian economists subsequently claimed.

However, this possibility points to a significant deficiency in Keynesianism, namely, its unfalsifiability. If it can always be claimed, in the face of an apparent failure of Keynesian theory, that disconfirmation was due to policy deficiencies, rather than to the falsity of the theory, than there is no evidence that can undermine the theory; it is unfalsifiable.

For the record, I have argued elsewhere that Austrian Business Cycle Theory is also unfalsifiable, though for different reasons. The Austrian theorist who predicts that inflation will eventually follow from exogenous manipulation of the money supply is like a meteorologist who predicts every day that it will rain tomorrow. Eventually, with a long enough time horizon, both predictions will be proven correct, but this doesn't mean that the relevant theory from which the prediction follows has been vindicated. More to the point, in the meantime separating manipulation of the money supply and the appearance of inflation – which may be a *very* long time, indeed – there is no evidence that can undermine Austrian Business Cycle Theory; it, too, is unfalsifiable.

Hirai: It is the George W. Bush Republican administration that was deeply involved in the "Lehman shock". Financial liberalization went far to progress the so-called "multi-layered securitized products." As a result, the Lehman shock finally occurred due to the collapse of the subprime loan, which brought about a chain of financial failure of major commercial banks and investment banks.

Keynesian thinking does not reveal naivety. It was the "New Keynesian School" under the Obama Administration that promoted Keynesian economic policies to deal with the Lehman shock.

Obama enacted the American Recovery and Reinvestment Act [ARRA] in February 2009. It was an essential policy with a full scale of 787 billion US dollars over two years to recover the American economy.

A significant feature of the ARRA was the revival of fiscal policy, which had hitherto been sealed as an economic stimulus, as an employment policy on a large scale (associated with infrastructure development and environmental policy). Economists and economic policymakers had been of the dominant view that interest rate policies (especially the Federal Funds Effective Rate guidance policy; see "Greenspan Magic") were sufficient for economic adjustment, and few had advocated fiscal policy.

(With the midterm election defeat, Obama's fiscal policy ended inadequately.)

Dimand: Certainly not, on several levels. First, although political pressures, sometimes involving invocation of Hayek, Mises and Austrian trade cycle theory, kept governments from responding as much as they should have to the financial crisis, central banks and governments nonetheless intervened sufficiently to prevent a second Great Depression. I vividly remember a column by a neo-Austrian economics professor at a Quebec university, published in the *Financial Post* the morning after Lehman Brothers was allowed to fail instead of being bailed out, proclaiming that this would end the crisis by restoring confidence. What happened instead was that the failure of Lehman Brothers caused a collapse of confidence that brought financial intermediation to a standstill, requiring massive intervention. Second, recall that Keynes described his *Essays in Persuasion* as the croaking of a Cassandra who could never influence the course of events in time.

Kurz: Many economists now are convinced that the 2008 financial crisis had a lot to do with liberalizing financial markets, which was recommended by economists such as Lucas, Fama, Prescott and so on, who often saw themselves as working in the tradition of Hayek. Several governments, most importantly the Reagan administration in the United States and the Thatcher Administration in Great Britain, in combination with central banks, followed their policy recommendations. Your question implies that the

failure of governments came in response to the financial and economic crisis, not in paving the way towards it. My view is exactly the opposite: The liberalization of the financial markets was the "original sin", so to speak, whereas the response afterwards was, if not perfect in execution, at least sensible in substance after the mess had been produced. Whatever its failures in craftsmanship, the policy avoided the complete breakdown of the world economy. Keynes had warned: "It is usually agreed that casinos should, in the public interest, be inaccessible and expensive. And perhaps the same is true of stock exchanges." Again, how right he was! Following the free marketeers sent the economic system into a tailspin downwards? How lucky the world was that Ben Bernanke had written his PhD thesis about the Great Depression and had understood that the crisis was dangerous and toxic and had to be fought by stabilizing the economy in terms of massive demand management. Had politicians and bankers only listened to Keynes, the financial crisis of 2008 could have been avoided. Taking the lesson that is to be learned from The General Theory seriously after the ball was over has at least prevented the worst from coming true (without removing some of the bombs that still are there).

It was not Keynes who was naive. As an adviser to politicians and central bankers, he knew the breed very well and he had a deep understanding of the financial sector and its inherent instability. It was Lucas and his acolytes, who prided themselves on having elaborated an allegedly superior theory (superior to Keynes's) and politicians willing to implement their recommendations, that were naive. The period under consideration will enter history as a major example of the dangers of what is known as groupthink and mind capture, leading to intertwined bubbles – intellectual, financial and economic. Jeffrey Sachs was right when he stated: "The financial crisis of 2008 was not an accident. It was the result of a long period of political decadence in the United States aided and abetted by a growing hole in economic science. ... [B]ecause of the centrality of US economic thinking in shaping global economic policies and institutions, the rest of the world has been carried with it into the fury." The difficulties cannot be blamed on "the" government as such, but has to be blamed on specific governments, and it has to be blamed, not on economics as such, but on specific schools of thought, especially the Chicago School and the libertarian branch of the "Austrian" school.

Against the background of compelling historical evidence, Adam Smith in *The Wealth of Nations* (1776) had already stressed the inherent instability of the financial sector and had firmly spoken up on behalf of its regulation: "Such regulations may, no doubt, be considered in some respect as a violation of natural liberty. But those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments, of the most free, as well as of the most despotical. The obligation of building party walls, in order to prevent the communication of fire, is a violation of natural liberty, exactly of the same kind with the regulations of the banking trade which are here proposed." Alas, it was the privilege of the moderns to blatantly ignore Smith and Keynes's perfectly sound warnings.

In commodity markets, economists typically count upon a negative feedback effect as regards the response of demand to changes in price, which stabilises markets: if the price of a commodity goes up, demand will shrink, which will decelerate and eventually reverse the rise in price. Can this effect also be expected to rule in financial markets? Or will the response of demand often involve a positive feedback effect? Apparently the two types of markets exhibit very different behaviours.

In view of the above, can it really be contended that the history of economics knows progress, progress and only progress, never regress? I wonder. This is another reason why it makes perfect sense to study the old masters, the emphasis being on "masters".

Klausinger: Keynes concentrated on a particular example where appropriate government intervention can stabilize "capitalism"; that is, how to respond to crises due to effective demand failures. In my view, there is not much in Keynes's theory that is helpful for the prevention of financial crises or for the special type of depression which follow them.

5) **Is capitalism too dynamic for philosophical reflection? By the time philosophers figure out what they want to say about capitalism, hasn't it become something else altogether?**

Backhouse: As Keynes noticed, capitalism evolves continuously. However, I am not convinced that it changes sufficiently rapidly to make all diagnoses out of date by the time they are published. As a recent example, I would cite Thomas Piketty's analysis of inequality regimes, cited below in answer to question 6. These regimes typically last for long periods of time, even if institutional details can change overnight. He has diagnosed some of the problems with our current regime in time for measures to be taken to change the situation, if the political will were there.

Caldwell: Hayek would probably agree with that statement, though he would couch it in terms of a market system being an example of a complex, adaptive emergent system.

Skidelsky: The leopard doesn't change its spots that fast.

Mikloš: Not only capitalism. Every society and social system is dynamic, complex and fundamentally hard to predict. Therefore, it will always likely be the case that our understanding is limited, and various theoretical constructs will always be simplified and temporary. Reality tends to reveal these limitations and imperfections sooner or later.

Boettke: I don't think so because I think philosophers can focus on the framework within which capitalism operates. It is that framework of rules and enforcement mechanisms (including Smithian approbation and disapprobation) that disciplines behaviour. Yes, technological forces are constantly evolving, and entrepreneurial innovations are forever emerging to offer us new and novel products, and services. But this cornucopia of goods and services is ultimately a function of the rules of property, contract and consent that are in operation in any society. The way one of my teachers James Buchanan put this is that we have the rules level of analysis, and we have the within-rules levels of analysis. It is through a thorough examination of the interaction of these two levels of analysis that we can perhaps gain useful knowledge of the political economy and social philosophy of the good society.

Scheall: Capitalism isn't an entity. What we call capitalism is shorthand for the complex interactions of myriad individuals acting in institutional environments that include markets, governments, and other non-market institutions. As these institutions change,

as these complex interactions give rise to different social effects, "capitalism" changes, too.

Isn't this philosophical reflection about capitalism?

Hirai: If I were to be asked, "Have not philosophical considerations fully grasped capitalism?" I would answer, "There exists some social philosophy underlying economics."

In the case of Keynes's New Liberalism, the emphasis is on economic efficiency, social justice, and individual liberty. The final chapter of *The General Theory* deals with "social philosophy."

Besides Keynes, Cambridge School economists – such as R. Hawtrey (the supremacy of socialism over capitalism), D. H. Robertson ("Liberal Interventionism"), and A.C. Pigou (the supremacy of socialism over capitalism) – also developed their own social philosophies.

Hayek's social philosophy is "the Theory of Spontaneous Order." He developed his social philosophy by fighting two enemies, external and internal. The former was what Hayek called "Constructivist Rationalism," and he developed a fierce criticism from the viewpoint of his liberal thought (including not only pure Constructivist Rationalists such as Saint-Simon, A. Comte, and K. Marx, but also Keynes, J. Schumpeter, and G. Myrdal). The latter was the market society view of Walrasian economics, and he continued to sound alarm bells from the viewpoint of the Austrian School. Hayek's unique liberal philosophy underlies this two-way battle.

When conceiving an economic theory, what kind of social philosophy should be embraced is crucially important.

Dimand: No, Carmen Reinhart and Kenneth Rogoff were justified in saying that "This time is different" are the most dangerous words in finance and economics. To assert that "By the time philosophers figure out what they want to say about capitalism, … it [has] become something else altogether" is to try to rationalize not wanting to learn from historical experience or economic analysis.

Kurz: If the question is meant to express doubts as to the capability of philosophy, economics, etc. to ever fully understand "the world" in which we live, then I agree, not least because we appear to be confronted with a growing socioeconomic complexity. But what follows from this? It would be a non sequitur to conclude: forget philosophy, economics, etc. We humans are bound to try to understand as best as we can the world in which we live. Any survival strategy will have to make use also of our understanding. Not to fully know and understand the world is one thing we grudgingly have to accept, trying to understand it and human motivations, decisions and actions better than before is an entirely different thing we desperately ought to strive for vis-à-vis climate change, belligerent actions that involve the possibility of extinguishing our species and so on. The problem is aggravated by the fact that the object of our perception is obviously a moving target: it does not stay put, but is continuously in travail. And humans are themselves responsible for a considerable part of the movement: we live in the Anthropocene. The assumption that we can do whatever we want, the planet will not be affected by it, was possible as long as the planet was relatively "large" compared to the population of humans, but this was the case in times long ago. Now we have to try to understand how human activity affects the environment, how the environment "strikes back", how humans respond

to it, and so on and so forth. It is perhaps interesting to note that already Marx saw humanity and the earth as two living entities and that it was unclear whether the two would get along with each other as time goes by. It was clear, however, which of the two would eventually be shaken off in case of conflict.

Klausinger: The well-known saying, "The more things change, the more they stay the same," makes some sense in this context. If we look at the succession of crises of the last decades (financial, covid, energy, climate), one common aspect is that the spectrum of solutions proposed ranges from those that rely on a system of state command to those that trust in "spontaneous order" emerging from individual action – and in between those who base their hopes on a boost in communitarian action towards the common good. Experience of government planning, directed to whatever aim in the past, does not recommend the first alternative. Yet with the evolution of capitalism and the emerging crises accompanying it, it is necessary for its legal framework to continually adapt. The challenge is, of course, that for this we must rely on a political system which otherwise we might suspect to be dysfunctional. Perhaps this is the crucial aporia we are facing.

6) Perhaps the most notorious feature of capitalism at the beginning of the 21st century is the large inequality of income that it is generating. Is this inequality compatible with Hayek's vision of a market society?

Backhouse: I leave it to experts on Hayek to elucidate precisely what Hayek's vision of a market society was and role he allowed for the state in framing the rules within which markets operate. Instead, I will offer some more general comments on markets and inequality.

Clearly, as both Keynes and Hayek recognized, we need a market society for reasons of both efficiency and individual freedom. The key question concerns the rules within which market activity operates. If governments and the electorates they serve are prepared to tolerate poverty, taking the view that if people starve or become ill through lack of warmth, this is the result of their own choices, then not only is high inequality compatible with a market society – it is a direct consequence of the type of market society that has been constructed.

Thomas Piketty's Capital and Ideology (2020) analyses the question though identifying what he calls inequality regimes: ideologies that either sustain or call into question inequalities and the market structures that lie behind them. This might be seen as an inversion of Marx, claiming that economic structures depend on ideologies, rather than vice versa.

So if Hayek's vision of markets includes an ideology justifying extreme inequality (and I leave it to Hayek scholars to say how far he went down that road), then the answer to the question is "Yes."

An equally interesting question is how far high levels of inequality undermine the price mechanism as a means for achieving social goals, such as reductions in pollution or averting climate catastrophe. In a perfectly equal society, a change in price typically causes everyone to adjust their consumption and can be an efficient way to allocate resources. Therefore, a carbon tax should provide an effective way to reduce carbon emissions. However, in a highly unequal society, a rise in the price of an essential

commodity such as food or fuel could condemn some people to poverty or starvation before the desired reduction in carbon emissions was achieved. In such a situation, more direct intervention would be needed. Such arguments lead to the conclusion that high inequality may make it impossible to achieve certain social goals through the price mechanism alone.

Caldwell: Hayek, like many liberals, was more concerned about poverty than about income equality, because a free market economy typically does generate income inequality while it is pulling people out of poverty. Hayek also emphasized the importance of equality before the law, the idea that all people be treated equally, and noted that most efforts at redistribution violate the standard of equal treatment before the law.

Skidelsky: Hayek would surely have detected monopolistic elements in the current distribution of wealth and incomes. In a properly competitive market economy, in which factors received their marginal products, and which included a competitive banking system, inequality of income would not be an issue for economics.

Mikloš: Hayek and Keynes had nearly opposite views on the role of the state in wealth redistribution and, consequently, in reducing income inequalities. While Hayek was fundamentally against it and considered the concept of "social justice" to be meaningless, viewing efforts to enforce it as dangerous and ultimately counterproductive, Keynes advocated for redistribution through progressive taxation and inheritance taxes. However, the primary motive behind redistribution for Keynes was not "social justice", but rather the aim to boost consumption and aggregate demand. He saw this redistribution as one of the three tools (alongside the expansion of monetary and fiscal policy) to allow full utilisation of resources that, in his view, a spontaneous, unstimulated market economy did not utilise adequately. His main focus was on bolstering consumption, including investments, at the expense of savings.

Hayek argued that any attempt at redistribution is unjust because it must be carried out "from above" by politicians, based on subjective criteria and often under the influence of interest groups. He believed that truly fair income distribution could only occur through competition in the market, including the labour market with regards to wage levels. Hayek also believed the motive to stimulate consumption was harmful, since it distorts the relationship between savings and investments, which he considered crucial. Manipulation of this relationship by the state, according to Hayek, leads to imbalances, inflation and crises.

Keynes regarded the stimulation of consumption as an important tool to fully utilise resources in a market economy, especially full employment. As a consequence, he also considered an unregulated (or unstimulated) market economy as unfair, since lower resource utilisation, especially labour, led to lower incomes and an unjust distribution of wealth. Keynes held a critical view of annuitant incomes, since he considered them to be unfair.

Boettke: I do *not* believe the gross inequalities that we have witnessed in the 21st century are consistent with Hayek's vision of a liberal order, for two reasons. Many – not all, but many – of these gains are due to privileges that were granted to various monied interests, rather than competitive gains in the market economy. You can see evidence of this in the amount of resources expended on lobbying efforts, as well as the concentration of wealth

since 9/11 and then the global financial crisis of 2008 in the Washington, DC area. Currently, several of the wealthiest counties in the US surround DC, something that historically has not been the case. Wealth was more dispersed in "second" cities across the US – New York, Chicago, Los Angeles, Boston, etc. – and those were more entrepreneurial cities. Washington, DC is a political city, and a political culture, and in short is a rent-seeking society. That violates Hayek's "generality" principle and his notion of the rule of law.

Scheall: "Capitalism" is not a causal agent. Markets do not exist in government-free vacua. Social effects emerge from the interactions of myriad individuals acting in institutional environments that include markets, governments, and other non-market institutions. I doubt that markets *per se*,rather than the interactions of markets and governments, generate income inequality. If income inequality exists in a market society, it might be markets, governments, non-market institutions, or (more likely) their various and complex interactions that generate this inequality. Placing the blame squarely on "capitalism" for income inequality, while ignoring government's likely role in helping to produce such inequality – e.g. through policies that, directly or indirectly, purposefully or unintentionally – favour particular classes of individuals, is painfully naïve, and unlikely to lead to effective counter-inequality policy measures.

To the extent that income inequality is generated by markets alone, rather than by markets embedded within and interacting with ignorant, venal, or otherwise ineffectual government actors, then I suppose it is compatible with Hayek's vision of a market society. But I see little evidence to suppose that free markets tend to generate income inequality in isolation from other relevant social factors.

Hirai: It can be said to be compatible with Hayek's vision.

Would Hayek have questioned income inequality? Wouldn't he have refused to allow the government to address income inequality?

Hayek's vision consists of his view of market society and the "Theory of Spontaneous Order." Individuals can only have on-site knowledge and information. What has been formed over time is a "Spontaneous Order," a typical example of which is the price system. It must be treated as essential. Hayek would therefore disapprove of a policy of artificially correcting income inequalities in the price system.

It was the Obama administration that did the most to reduce income inequality. It argued: There are a massive number of Americans without health insurance coverage. The construction of a government-led safety net for them is essential in correcting the widening gap between the rich and the poor caused by excessive liberalization.

Many difficulties stood in the way of this realization, but in March 2010, the "Affordable Care Act" (more commonly known as "Obamacare") was enacted.

This is Keynesian in spirit. It is based on the same idea as the British "Beveridge Report (1942)," to which Keynes significantly contributed, assisting William Beveridge.

Dimand: "Is inequality compatible with Hayek's vision of a market society?" Yes, certainly it is. Hayek cared about poverty, not about inequality except in so far as inequality was a cause of poverty. What he deplored was that poor people were poor, not that other people had more than they did. The remedy for poverty, as he saw it, was wealth creation. Inequality of income and wealth follows inevitably from the incentives that drive such

wealth creation. Pending the elimination of poverty by wealth creation, Hayek countenanced the mitigation of distress by society but, like other economists from Milton Friedman to James Tobin, he urged that this be done by cash transfers (as by a negative income tax or guaranteed annual income), not by measures such as rent control that interfere with price signals.

Kurz: Why should it not be compatible with Hayek's vision of a market economy? According to him, markets effectively solve the problem of imperfect knowledge of each and every single agent by collecting all the knowledge available in the economy across all agents and consolidating it in the actual system of market prices. These prices are assumed to reflect adequately the preferences of agents, the amounts of productive resources available in the system and the cost-minimizing methods of production by means of which goods and services can be produced to satisfy needs and wants. Prices "embody", so to speak, ideally all the information available. What single agents do not know, the Market is supposed to know. If income distribution happens to be highly unequal, let it be: the Market wants it to be so. How could you dare to question the omniscience of the Market?

Put in a nutshell, this is the basic viewpoint of "market radicals". There are, however, problems with this view, at least three of which ought to be mentioned. First, there is no presumption that all agents composing a society are able to survive, given the resulting prices vis-à-vis their initial endowments (labour power, possessions, etc.). They might be destined to starve to death or die because they are unable to get essential medical treatment and so on. Hayek was aware of this, as were Kenneth Arrow and Gérard Debreu in their 1954 discussion of the existence of general equilibrium. Since a change in the number of agents would request putting up a new model, they decided to assume that the initial endowment of each and every agent is large enough to allow the agent to survive even if he or she does not partake in market transactions and does therefore not depend on market prices. This is a very bold assumption. An equilibrium may therefore exist in which several agents (in the extreme: all) remain in a state of autarky and only a few (none) do what Lionel McKenzie called "a little trading on the side". Within such a framework, social relations may be relatively unimportant and economic interaction weak, contrary to what we experience.

Secondly, as David Starrett demonstrated in 1978, social cohesion vanishes entirely when one takes the spatial dimension of economic activity into account in the simplest case possible. Then the competitive price mechanism formalised by Arrow and Debreu can explain neither the emergence of spatial economic agglomeration nor substantial trade streams. In fact, with constant returns to scale, economic activity will be evenly distributed across a homogeneous plain, carried out by autarkic units of production and consumption. There is no society in any meaningful sense. This runs counter to the challenge assumed by methodological individualism to reconstruct society as it is by starting from utility-maximizing agents.

Third, the assumption that market prices contain all the information available in an economic system cannot be sustained. As Arrow, Stiglitz and others pointed out, the general equilibrium argument seeking to establish the efficiency of markets does not take into account what to Joseph A. Schumpeter is the alpha and omega of capitalism: its drive to "innovation" from within. Who can possibly know which innovative activities firms are about to launch and the information about which they hide meticulously? And even

if the novel technical designs happen to be knowable in advance, who is able to predict the processes of "creative destruction" that will disrupt the economy, the employment effects they will have, the firms and economic branches that will go out of business, the performance of the stock exchange and unstable banking sector? Last, but not least, what will be the impact of innovations on income distribution? It is a myth that actual prices contain all the economic information that there is.

Klausinger: Hayek does not regard inequality per se as incompatible with his vision of the market economy. Rather he argues that history teaches that innovation and progress are tied to the possibility for some of appropriating gains (profits), which over time will result in better outcomes for (almost) all. He concedes that the market will not be able to guarantee a distribution of income according to "merit" (however defined). Yet inequalities may be excessive or "unjust" if they result from an "unjust" legal framework. It should also be noted that Hayek was in favour of a modest minimum income for those unable or unwilling to work.

7) **Does either of our architects of capitalism successfully portray the range of human behaviours that define life in a capitalist society?**

Backhouse: I doubt that anyone has portrayed the full range of human behaviours in capitalist societies, whether these two economists or anyone else. Keynes certainly recognized that motivations were complex, his analysis of financial markets illustrating that. Awareness of the complexity of motivations was presumably a reason why he did not adopt much simpler theories of consumption and investment that could be captured in algebra (simple algebraic consumption, investment and money-demand functions do, of course, exist, but they are oversimplifications of what he says in his text).

Caldwell: I am not sure that either of them was trying to do that!

Skidelsky: No single model captures the range of behaviours in any social system. I would prefer the general statement that people on the whole do the best they can in the situations in which they perceive themselves to be. In that sense, they behave rationally. But this is far from the neo-classical model of rationality in which agents have perfect information about all possible outcomes of their actions, and choose the behaviour with optimises their advantages.

Mikloš: Keynes introduced the concept of "animal spirits", in which he attempted to describe how human behaviour functions in market economies and how it influences consumer confidence. Later, based on this concept, a highly influential branch of behavioural economics emerged, which explains why people (also) behave irrationally in their economic decisions and relationships, as well as what determines the behaviour of investors during times of instability. This essentially challenges the original concept of the classical economic school, which was based on the assumption of rational economic behaviour by economic agents (Homo economicus).

Boettke: Not sure I understand the question fully, do you mean more or less the meaning of life, or our "great purpose". I don't think either Keynes or Hayek has a book the equivalent of Adam Smith's Theory of Moral Sentiments, which does have not only deep observations about human beings, but also practical guides to human behaviour. My favourite of which is his point about how anger and hatred are poison to a good mind. Smith was a special thinker, unclear those that came after him ever rose to the same heights of observational genius. But they became more specialized in the technical arguments about commercial society. Among modern economists Hayek was a Smithian, and his discussion of the rules of just conduct are vital to his defence of liberalism. But McCloskey digs much deeper into the virtues required to sustain and advance a liberal society. Sen, like most others who hope to move economics at least slight back to its political economy and moral philosophy roots is more about the system and its consequences, e.g., in his book Development as Freedom. There are many others who usefully contribute, and of course there are several heterodox thinkers (or mainstream in other disciplines) such as the Moral Economy types following Karl Polanyi, but I do not find them as helpful. Again, my biases show.

Scheall: No, but given the complexity – the multi-causal, feedback-laden nature – and dynamism of the phenomena, why would anyone expect them to successfully portray the range of human natures that define life in a capitalist society? Both scholars got some things right, some things wrong, and ignored a host of other considerations, as any cognitively-limited being reflecting on the nature of modern society is bound to do.

Hirai: Hayek's view of the individual and the theory of the Spontaneous Order vs. Keynes's New Liberalism of the individual and social organization: Keynes seems more realistic than Hayek.

It is necessary to point out the difference by referring to the characteristics of the two social philosophers. The following point expresses it well.

Hayek, in *The Road to Serfdom* (1944), criticized not only Nazism and Socialism but also Keynes's stance, stating that they would lead to the road to serfdom. After reading the book, Keynes wrote to Hayek, "you greatly underestimate the practicability of the middle course. … you are trying to persuade us that so soon as one moves an inch in the planned direction you are necessarily launched on the slippery path which will lead you in due course over the precipice (sic)."

Keynes instead thinks that an ideal organization should be somewhere between the individual and the state, and highly appreciates the development of organizations that have been produced as a result of the historical progress of the market society, such as the growth of "semi-autonomous bodies within the State" and the "tendency of big enterprise to socialise itself (sic)."

Dimand: "Does either of our architects of capitalism successfully portray the range of human behaviours that define life in a capitalist society?" Can any one writer portray the full range of human behaviour? I commend attention to the work of G. L. S. Shackle who, having earned doctorates at economics at both Cambridge and LSE in 1937-40, drew on the insights of both Keynes and Hayek.

Kurz: I would prefer to speak of "interpreters" of capitalism in the first place and only as architects of it in the second place to the extent to which they actually influenced economic policy, the formation of institutions and so on. And let us not forget that human action does not only, if at all, realize what human action was designed to accomplish, but typically has consequences no agent ever foresaw or could possibly foresee. As Adam Ferguson put it, history is the result of human action, but not of human design. Neither Hayek nor Keynes had the power to overcome this truth. As regards the "range of human behaviours" referred to, both authors had interesting things to say, but I wonder whether they measure up to David Hume in his A Treatise of Human Nature (1739-1740) or Adam Smith in The Theory of Moral Sentiments (1759). These two authors anticipated several findings of Behavioural Economics, such as endowment effects, herd behaviour and so on, which undermine the usual efficiency postulates of conventional neoclassical economics.

Klausinger: Here I want to restrict my answer to the observation that neither of them assumes that individuals will act as superhuman maximizers of whatever. Rather both emphasize that ordinary people often will follow rules (Hayek) or conventions (Keynes).

8) Do the various government responses to Covid-19 provide support for either Hayek's or Keynes's vision?

Caldwell: My own view is that most government responses to Covid, especially the long mandatory lockdowns and nearly universal refusal to experiment with alternative approaches, is a case study in the dangers of elites using the authority of science to direct policy and using only very narrow criteria for selecting appropriate policy. Economic and other costs were seldom considered. The main metric was keeping the hospitals from being overcrowded. Targeting and protecting the most vulnerable (the elderly and immune- compromised) was recommended as an alternative policy in the United States, and its proponents were castigated as unscientific ideologues. We are seeing the dire effects of the policies that were enforced in terms not only of lost output, but also in enormous increases in government debt and equally grim statistics about declines in student learning. In the US at least this last has taken a toll particularly on lower income households. I think that my response is wholly consistent with Hayek's view of the dangers of policies made by elites, and of the dangers of scientistic, as opposed to truly scientific, reasoning.

Mikloš: Of course, they do, however, they lean more towards Keynes's vision than Hayek's. Still, it's not just about government responses and government policies. The entire economic system as we know it today, as well as economic policy as a whole, is significantly influenced by Keynesian teachings.

The fundamental difference between Keynes and Hayek is that while the former addressed the societal and economic system from top to bottom (macroeconomics), the latter envisioned it as a spontaneous system built from the bottom up (microeconomics). Today's capitalism, especially concerning the role of the state in the economy and economic policy tools, is a Keynesian system, not a Hayekian one. Even the most famous liberal economist of the 20th century, Milton Friedman, was closer to Keynes in the field of economics and economic policy than to Hayek. Hayek himself acknowledged this fact.

The biggest challenge in comparing Hayek and Keynes lies in the fact that we are comparing a system we know and live in (Keynes's world) with a system that never truly existed (Hayek's world), and the real world (Keynesian) has been moving further and further away from the latter over the past century. And so, when it comes to whether Hayek's world would be better today, we can only speculate.

Boettke: See above my point about the tacit presuppositions. Hayek does admit emergency measures are sometimes called for, but he also warns about emergency measures being an excuse for increased central authority. I have written a few things about Covid, which range from discussions of monetary and fiscal policy impact (I do think the NBER paper by Sargent comparing how we paid for WWI and WWII and then Covid is worth really studying). I published a paper with Ben Powell in the Southern Economic Journal on "The Political Economy of Covid" and I published a paper in the Georgetown Journal of Law and Public Policy on "Liberalism tested". The first deals with the brine of politics associated with emergency measures, the second tries to test Mill's harm principle against a serious issue of infectious disease.

The reality is the world chose to rely on a more or less command and control approach to address this serious public health issue, and thus one might, if painting with a very broad brush, demonstrate once again the appeal of a Keynesian policy approach. Hayekian policy was rejected as either impractical or worse. I would like to challenge that rejection, but not by denying the severity of the problem we faced (and continue to face) but by engaging in a counterfactual thought experiment where Mill's harm principle was the guiding force and polycentric solutions and variation in experimentation and entrepreneurial innovations were more relied on than government mandates and government-guided medical responses. There was in the way we pursued things still a tragic loss of life, and deep impact on societies and commercial life. 'Could we have done better?' seems a reasonable question, rather than merely assuming that any alternative way would have produced far worse results. They very well may have, but we should use whatever means we have at our disposal to examine the counterfactual so we can learn. At least that is my hope, and I hope that my efforts in the two articles I mentioned push others to think along those lines. But none of us knows that answer, we just know what we did and what were the results and what we are facing as consequences for that, given the trade-offs that were made. A true accounting will probably take several decades of sustained conversation among social scientists and historians. So we better find a way we can talk to each other.

Scheall: Inasmuch as Hayek was obviously the greater sceptic about the possibilities of effective policymaking in the face of extremely complex phenomena such as those that governments confronted in early 2020, and inasmuch as government responses to Covid-19 were (with the exception of the responses of Sweden, South Dakota, Florida, and a few other governments around the world) among the gravest policy errors in modern history, there's no doubt that these responses provide more support for Hayek's vision. I have written about this topic in my "A Case Study in the Problem of Policymaker Ignorance: Political Responses to COVID-19":

https://cosmosandtaxis.files.wordpress.com/2021/05/scheall_crutchfield_ct_vol9_iss_5_6.pdf

Hirai: Hayek was suspicious of the government's activities. He saw the economy from the perspective of governments and institutions becoming oversized and distorting the price system. In other words, the perspective of the government's response was lacking from the beginning.

On the other hand, Keynes worked tirelessly to solve many challenging problems during WWII, such as the lend-lease problem, the commodity problem, the international monetary system (International Clearing Union), the reparations problem, and the social security problem.

Regarding the Covid-19 pandemic, each country has taken various measures to prevent its spread – vaccination, travel restrictions, and business restrictions in the service industry – that have caused an increase in unemployment and a sharp decline in the real estate sector (among others, in China and South Korea).

Moreover, the war in Ukraine has posed a severe problem. Inflation due to a sharp decline in the supply of wheat and oil has attacked the world. We might also mention the Federal Reserve Bank's continuous rise in the policy interest rate. Thus the world has suffered from great stagflation.

The story does not stop here. Russia has continued to suffer from a hefty defeat, making its geopolitical position in the world very vulnerable.

Kurz: I wonder whether a sensible answer can be given to this question. What I think can and ought to be said is this: First, much of economics is about what are known as "private goods", which are defined by rivalry in consumption and excludability, whereas "public goods" are taken to be non-rival and non-excludable. Secondly, the importance of public goods or rather "public bads" (e.g. pollution) has in my view increased dramatically in modern times and much more attention deserves to be dedicated to how public goods can be protected and preserved and public bads avoided and fought. Covid-19 is both a private and a public bad that has significant undesired effects.

Klausinger: In some sense this comes down on the question, "What would Hayek/Keynes have said about … [insert: covid-19]?" This is a situation rather far apart from these men's experiences so that I would not dare to claim to know the responses. From a (classical) liberal point of view Hayek might have preferred appeals to personal responsibility over compulsion (like lockdowns). On the one hand, the conditions created by the existence of a contagious disease like covid-19 are most probably not such that we can trust in the desirability of the results of a "spontaneous order" based on such appeals only. On the other hand, government responses in the various countries often resulted in "unintended consequences," that is, effects unforeseen even by scientific experts. In any case, we should be prudent with criticisms of government policies based on ex post-knowledge that ex ante was not possessed by anyone.

ON "DEFUNCT ECONOMISTS" AND THE USE OF ECONOMIC IDEAS

Steven G. Medema[1]

> "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually slaves of some defunct economist."
>
> John Maynard Keynes (1936, p. 383)

One Friday afternoon a dozen or so years ago I sat in on a freshman honours seminar led by one of my colleagues. This weekly seminar featured guest speakers from various walks of life, and that week's speaker was a state legislator who happened to be a member of the Republican party. At one point during his talk, the legislator emphasized that he was not a "Keynesian," for he was opposed to expansive government expenditures, seeing tax cuts as the path to economic growth. During the Q&A period that wound up the session, I raised my hand and, when called upon, informed our speaker that Keynes (1936), too, saw tax cuts as a tool for economic stimulus, meaning that our speaker was, unknowingly, a Keynesian. His reaction was one of disbelief, that I could not possibly be correct. Of course, he had never read Keynes. He had simply been taught that Keynesian economics meant big government and so was bad, and he was only too happy to parrot that line.

It has become gospel among those on the left that 'neoliberalism' is responsible for most of the maladies that afflict the world today. What that 'neoliberalism' consists of is difficult to pin down, as the only consistent element in the literature is "right-wing ideas that I don't like." But this choir sings with an almost singular voice when it comes to identifying the intellectual villain of the story – one F. A. Hayek, the founder of the Mont Pelerin Society from which emerged the "neoliberal thought collective." Hayek is best known as a promoter of individual liberty and for his insistence that information problems typically make the pricing system a better coordinator of economic activity than is the state (Hayek 1944). In the hands of the left intelligentsia, however, his ideas have been transmogrified into an anti-democratic agenda, support for corporate power (and attendant consumer exploitation) run amok, and efforts to choke off the state (at least apart from its support for corporate power) by subjecting its activities to the cost-benefit test. Each of these claims is laughable in its own way, though perhaps none more so than the last, given that Hayek's own words, to say nothing of his subjective theory of value, rule out the very possibility of doing cost-benefit analysis.

Of course, one person's villain is another person's saviour, and Keynes and Hayek are no exceptions. Lord Skidelsky and the legion of those shouting, "See, Keynes was right!" following the crisis of 2008 want us to be clear that the great man provided us with timeless economic truths, particularly regarding the ability of governmental policy gymnastics to successfully accomplish all manner of things, that we neglect at our peril.

1 This text was written as a response to the questions posed in the debate on the architects of capitalism.

And woe betide those who cross the Hayekians, the most rabid of whom seem to see every new government program as moving us ten steps closer to serfdom and any imperfections in government activities as a clear signal of Hayek's profound insights about the evils of state action. Fear the disciples.

What has any of this to do with this symposium dealing with the ongoing value of the ideas of Keynes and Hayek? Well, everything. The symposium effectively pits Hayek vs. Keynes, not unlike the famous rap video and, indeed, so much scholarly debate. Intellectual lines are drawn, policy territories established, and dutiful foot soldiers occupy their respective camps. In the process, economic argument comes to resemble theology, with deviations from a particular orthodoxy not countenanced. Keynes *and* Hayek? Don't be silly. Each side plays the game of Copernicus vs. the Church. There is right, and there is wrong, and no right-thinking person would countenance the possibility common ground, fruitful pairing, and that the insights of each point to the profound limitations of the ideas of the other.

One of the bright threads in the carpet that is the history of economic ideas is a to and fro over the possibilities and limitations of market and state. Centuries of economic thinking focused on the dangers arising from the self-interested behaviour of consumers and producers and advocated for strong and high state bumpers to restrain these excesses. This gave way, at the hands of Mandeville, Smith, and others, to a story about how the marketplace could, by and large, channel self-interest in appropriate directions, in some versions with a greater emphasis on market success and in others on government failure. The twentieth century saw the worm turn twice more – first, with an increasing unease with the extent of market failure and a growing confidence in the ability of economic expertise to devise remedies, and then in the attempt to demonstrate that these confidences were misplaced, with the seeming inevitability of government failure demonstrated using the very theoretical tools that had identified the failures of the market (Medema 2009).

Keynes and Hayek have become, in our age, emblematic of – indeed, poster-children for – these latest turns, victims of the inexorable urge to depict economic life in terms of market vs. state. We arrived at this point via a historiography where close reading is sacrificed to caricature, and nuance cannot be allowed to get in the way of a good story. None of this is to deny the fundamental hermeneutic problem. That the scholarly literature is replete with Keyneses and Hayeks, to say nothing of Smiths and Ricardos, is evidence enough for that. But it is fair to say that neither Keynes nor Hayek would recognize the person so labelled by many of their critics, or even by many of their ostensible disciples.

Any number of those who advocate re-centering the history of economic thought in the economics curriculum, particularly at the graduate level, do so because they believe that "If only economists would read [pick your preferred unjustly neglected figure from the past], they would become aware that there was a better way of doing economics". These same individuals are also of the mind that there are clear, obvious, and consistent answers to the questions put to the authors of this symposium. Those who see no value in history of economics education, on the other hand, tend to be of the mind that all useful ideas from the past are incorporated in the economics of the present. For them, the answers to the symposium questions are irrelevant, as modern economics, rather than the musings of dudes long dead, provides the proper vehicle for thinking about these things. The intellectual hubris reflected in each of these positions cannot be understated.

One of the defining characteristics of social science is that ideas are almost inevitably incomplete. A second is that, in part because of the first, they are also almost inevitably contradicted by experience. Maybe not today, and maybe not tomorrow. But eventually, and

often repeatedly if one takes a sufficiently long view. There is no Newton or Einstein waiting to provide timeless answers to economic questions – theories that are True, and simply await empirical verification. Life is messy. Bits of useful scholarly insight lay side-by-side on the page, or in the *oeuvre*, with the cringeworthy. The author of *The General Theory* also wrote *A Treatise on Money*. "The Use of Knowledge in Society" was preceded by *Prices and Production*. Even the best of footballers put it wide of the net with some regularity.

It is no sin to attempt to find kernels of utility for the present in the ideas of the past. Indeed, it is fair to say that all progress, whether in the realm of ideas or in things more practical, inevitably builds on the successes – and yes, failures – of our forebears. But grave dangers await when we chart our course by genuflecting before venerated saints, pretending that we can find in their scribbles the cures for even our minor afflictions, let alone the path to salvation. Capitalism is a delicate and difficult beast. Financial markets are complex, heterogeneous, and evolving. Covid has claimed the lives of millions and certain of the responses to it have caused less currently calculable but no less real damage to the lives of millions more. Poverty and massive inequality have been a virtual fact of life through most of human history. To pretend that Keynes or Hayek give us the proper lens through which to view these issues or can provide *the* answers to the associated challenges is foolhardy. To pretend that either of them has nothing of use to offer when thinking about these challenges is equally absurd. The uncomfortable truth is that reality in turn stomps on and vindicates the ideas of both Hayek and Keynes; we disregard each at our peril.

Is all of this just a plea for pragmatism, which some would regard as the refuge of the simple-minded? Perhaps in part. But much more than that it is an argument that the complexities of reality can only be met through a thought process that is equally complex, the product of a cacophony of voices and perspectives. I am not talking here about Keynesians and Hayekians and Friedmanites and Marxists and other assorted 'ists' and 'ians' each insisting that we order economy and society in *their* way, *tout court*, thereby choosing the road to heaven rather than perdition, with actual outcomes determined by who can get the most votes or force their strongman into power. Rather, I am suggesting – indeed, insisting – that real and consistent progress in meeting society's most profound challenges will only come through an intellectual eclecticism that is, and perhaps always has been, all too rare. Not coincidentally, Keynes and Hayek understood this well, learning from each other as well as from others of rather different stripes. And I expect that Keynes would have found much value in Lucas and Hayek in, say, Tirole. At this point, the disciples simply turn away, shaking their heads – and this author smiles, knowing that his point has been made.

[I am grateful for the encouragement provided by Bradley Bateman during the preparation of this essay, and I have benefitted greatly in this process from the insightful commentaries on Keynes and on Hayek found in Bateman (2006) and Caldwell (2020).]

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Claridge Hotel,
Atlantic City, N.J.
28th June 1944

My dear Hayek,

The voyage has given me the chance to read your book properly. In my opinion it is a grand book. We all have the greatest reason to be grateful to you for saying so well what needs so much to be said. You will not expect me to accept quite all the economic dicta in it. But morally and philosophically I find myself in agreement with virtually the whole of it; and not only in agreement with it, but in a deeply moved agreement.

Turning to a few special points, I think you strike the wrong note on Page 69 where you deprecate all the talk about plenty just around the corner. No doubt this is partly due to my having a different view to yours about the facts. But apart from this, would it not be more in line with your general argument to urge that the very fact of the economic problem being more on its way to solution than it was a generation ago is in itself a reason why we are better able to afford economic sacrifices, if indeed economic sacrifices are required, in order to secure non-economic advantages? It seems to me that it is in this particular matter above all that the Communist doctrine is so desperately out-of-date, at least in its application to U.S.A. and Western Europe. They ask us to concentrate on economic conditions more exclusively than in any earlier period in the world's history precisely at the moment when by their own showing technical achievment is making this sacrifice increasingly unnecessary. This preoccupation with the economic problem is brought to its most intense at a phase in our evolution when it is becoming ever less necessary.

The line of argument you yourself take depends on the very doubtful assumption that planning is not more efficient. Quite likely from the purely economic point of view it is efficient. That is why I say that it would be more in line with your general argument to point out that even if the extreme planners can claim their technique to be the more efficient, nevertheless technical advancement even in a less planned community is so considerable that we do not today require the superfluous sacrifice of liberties which they themselves would admit to have some value.

One point which perhaps you might have pressed further is the tendency todya to disparage the profit motive while still depending on it and putting nothing in its place. The passage about this on page 97 is very good indeed; could not be better; but I should have liked to have seen this theme a little more expanded.

On the moral issue, I also find the last paragraph on Page 156 extraordinarily good and fundamental.

An unsigned letter sent by Keynes to Hayek regarding *The Road to Serfdom* (King's College, Cambridge)

Nepodpísaný Keynesov list Hayekovi o Ceste do nevoľníctva (King's College, Cambridge)

I come finally to what is really my only serious criticism of the book. 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 is not possible. But you give us no guidance whatever as to where to draw it. In a sense this is shirking the practical issue. It is true that you and I would probably draw it in different places. I should guess that according to my ideas you greatly underestimate the practicality of the middle course. But as soon as you 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 so soon as one moves an inch in the planned direction you are necessarily launched on the slippery path which will lead you in due course over the precipice.

I should therefore conclude your theme rather differently. I should say that what we want is not no planning, indeed I should say that we almost certainly want more. But the planning should take place in a community in which as many people as possible, both leaders and followers, wholly share your own 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. This is in fact already true of some of them. But the curse is that there is also an important section who could almost be said to want planning not in order to enjoy its fruits but because morally they hold ideas exactly the opposite of yours, and wish to serve not God but the devil. Reading the New Statesman & Nation one sometimes feels that those who write there, while they cannot safely oppose moderate planning, are really hoping in their hearts that it will not succeed; and so prejudice more violent action. They fear that if moderate measures are sufficiently successful, this will allow a reaction in what you think the right and they think the wrong moral direction. Perhaps I do them an injustice; but perhaps I do not.

What we need therefore, in my opinion, is not a change in our economic programmes, which would only lead in practice to disillusion with the results of your philosophy; but perhaps even the contrary, namely, an elargement of them. Your greatest danger ahead is the probable failure of the application of your philosophy in the U.S. in a fairly extreme form. No, what we need is the restoration of right moral thinking - a return to proper moral values in our social philosophy. If only you could turn your crusade in that direction you would not look or feel quite so much like Don Quixote. I accuse you of perhaps confusing a little bit the moral and the material issues. Dangerous acts can be done safely in a community which thinks and feels rightly, which would be the way to hell if they were executed by those who think and feel wrongly.

Yours ever,
/s/ Keynes

Prof. F.A.Hayek,
The Old Oast House,
Malting Lane,
Cambridge