



## Episode 1,082: The Truth About F.A. Hayek

Guest: Joe Salerno

**WOODS:** Let's talk about Hayek.

**SALERNO:** Great.

**WOODS:** I had a bunch of listeners ask me about this, or not ask me, but there was a thread in our private group about Hayek, because I think people just want to know what should I think about Hayek. He obviously makes important contributions, but then there are other parts of Hayek that are downright maddening, and we want to know how do we assess the guy overall.

So I'd like to start actually maybe with the duller part, and yet in a way maybe the most important. If we can say something about Hayek's specific work in economics, because nearly all his cheerleaders out there are cheering for works that are not strictly economics, works like *The Road to Serfdom* or his *Law, Legislation and Liberty* trilogy or *The Constitution of Liberty* or whatever. Those have some economics in them, but the real scientific economics that he did earlier on is not really what they're pointing to. But of course that's what he won the Nobel Prize for. So his major work tends to get eclipsed. In fact, he himself was rather surprised — and I'm not even sure especially pleased, I don't know — that *The Road to Serfdom* was what he wound up being known for when that was a book that didn't take him all that long to write, and these other works are his real contributions to his field. So as somebody who wrote the foreword to a recent edition of Hayek's work *Prices and Production*, can you give us, to the extent that you can make it layman-friendly, a bit of background about the economics of Hayek?

**SALERNO:** Yes. Hayek was very interested in business cycle theory. His first article on that came out in 1928. He had actually visited the United States early in the 1920s and already by that time saw that Fed policy was artificially pushing the interest rate down below what we Austrians call the natural rate, which is the rate that is determined by the voluntary savings of the public. So Hayek saw that and also saw that American economists thought that this was a good thing, because in pumping new money into the economy, the Fed was pumping it in at such a rate that it was keeping prices stable. But of course the 1920s was an era of tremendous technological improvement and capital investment, and we had refrigeration coming in, we had mass production of cars, we had the radio. So prices should have been falling, and they should have been falling fairly rapidly — that is, what we call a growth deflation should have been occurring, which is lowering prices to consumers of goods whose costs are falling in production. That wasn't happening.

Hayek saw that, and he said in order to keep these prices from falling, the Fed is engaging in monetary inflation. It's suppressing the interest rate, and that is causing entrepreneurs, in addition to this legitimate growth, to make investments that would later turn out to be malinvestments or bad investments. So that was the background. Hayek, really, he was 23, 24 years old when he visited the United States, and he had this deep insight into what was going on in the U.S. economy and how it all would end eventually.

**WOODS:** But how is that insight different from what Mises had already said in *The Theory of Money and Credit*?

**SALERNO:** Well, the insight itself wasn't different, and he was very conversed with Mises' writings. But what he developed from that, in 1928 he wrote a very important article on "The 'Paradox' of saving," in which he dealt in detail for the first time, really, with this idea that how could we have more investment if people are cutting back on their consumption to save more. And of course, later on Keynes was to make a big deal about this. Keynes called it the paradox of thrift, and he said that the very fact of saving causes leakage out of the system — that is, money is being saved and not spent on consumption goods, so why should investment increase?

Well, Hayek pointed out just what was happening. It wasn't that purchasing power was being lost to the system; it was simply that it was being transferred. People were buying fewer consumer goods and saving the money, but in saving the money they wanted a return on it. So they were investing it either in stocks and bonds or through banks and other financial institutions in the capital goods industries. And so we had more capital goods being produced, fewer consumer goods for the time being. And when these capital goods — these new factories, these additional raw materials, these new discoveries of natural resources — when they came online, that made labor more productive and lowered the costs of these consumer goods, so that in the future people had access to the lower-priced consumer goods and their standards of living rose.

So Hayek in that case was not talking about the business cycle but just how a capitalist economy could bring about sustainable growth, sort of like we have today. I mean, look, HD television sets when they first came out in the 1990s were \$30,000. Technological improvement brought the price down to \$500. That took a tremendous amount of saving and investment, but eventually the fruits were the lower price and higher quality HD TVs. And we could say the same thing about LASIK surgery, tablet computers, and so on.

So Hayek saw saving and investment, this reduction in consumption for the time being and the transfer of consumption into the future — that is, people didn't not want consumer goods anymore, as Keynes implied. What they wanted was to change the temporal pattern of when they were consuming goods. They wanted more goods in the future. They were saving for their kids' tuition or for their retirement or for a new house, so they were postponing their consumption. And Hayek basically followed out the implications of that and showed that that was sustainable and would bring about continuing growth in the economy.

**WOODS:** I want to say something about the accessibility of some of Hayek's works, because even though people find *Human Action* to be difficult sometimes, I think it's actually less difficult than you think it's going to be given the size of it and given the difficult opening sections. But all the same, at least I hear people saying, I'm reading *Human Action* or I read *Human Action*. I don't think I ever hear somebody saying I'm reading *The Pure Theory of*

*Capital* or I'm reading *Prices and Production* by Hayek. Now, why is that? Is there something that's inaccessible about Hayek?

I actually recall a — and I don't know if this is apocryphal or not, and I don't know if it was Walter Block who was involved. But I heard a story that at a Liberty Fund colloquium that Milton Friedman was attending, he was talking about how opaque Hayek's economic writing was, and I think he said to Walter or somebody who was there, "Could you actually get anything out of *Prices and Production*? I can't make any sense out of a word of it."

**SALERNO:** Well, a couple of points to be made on that. First, *Prices and Production* is an extremely compressed book. It was a series of lectures that he gave at the London School of Economics that he was invited to give in 1931. And so he put together the lectures and it's compressed, and it is quite opaque. And *Pure Theory of Capital* was really one of the few books that was a failure. I mean, he didn't really get his point across. So those two books I would recommend reading later on. And you really don't even have to read, as Murray Rothbard pointed out, the whole *Pure Theory of Capital*. The first five chapters are extremely accessible, and they give the difference between Austrian capital theory and mainstream capital theory in a very clear way.

But what I do want to suggest is that people read this article that was written in German, translated into English. It's very clear, and it pretty much says most of what is in *Prices and Production*, and that's "The 'Paradox' of Saving," and it's article-length. And when I started reading Hayek, that was one of the articles that opened my eyes. The other small book they should read, which was written by Hayek in 1929, I believe, is *Monetary Theory and the Trade Cycle*. That's also quite accessible. It's really just a long article that was sort of made into a book. It is a book, though. So you have to pick and choose what you read by Hayek. Many of his writings in the '30s are not that accessible to the layperson.

**WOODS:** Okay, now, is that article that you just mentioned that was also a book, is that the same as the essay by him in the Ebeling collection, *The Austrian Theory of the Trade Cycle*, or are those two different things?

**SALERNO:** No, those are two different things. You can find that article in the book I edited by Hayek called *Prices and Production and Other Essays*, and that's one of the other essays.

**WOODS:** Okay.

**SALERNO:** Yes, it can be found there.

**WOODS:** All right, so we're going to link to all this stuff. The show notes page will be [TomWoods.com/1083](http://TomWoods.com/1083), so we'll link to all this stuff. Let's get to this stuff about Hayek and the intellectuals —

**SALERNO:** Wait, may I say just one more thing?

**WOODS:** Yeah. Please do.

**SALERNO:** Everything that Hayek wrote after he received the Nobel Prize, all his pamphlets, interviews, and small booklets are extremely accessible. He was talking directly to the public,

to the informed public after he received the Nobel Prize in 1974. So I recommend *Choice and Currency*. I recommend a lot of his interviews. There's also a book called *Hayek on Hayek*, which is a collection of his interviews and reminiscences. So all of those things I recommend.

**WOODS:** Okay, also good. Also good. All right, I'll jot all this down too. Excellent. All right, let's move on not to the discussion of his essay, "The Intellectuals and Society," I think it's called, which is a very well-known —

**SALERNO:** "Socialism," "The Intellectuals and Socialism."

**WOODS:** "The Intellectuals and Socialism," is that what it is? Okay.

**SALERNO:** Yeah.

**WOODS:** Okay, so we'll get to that in a minute because that's very well-known. There's a lot to say about that. But let's talk about in general the aspects of Hayek's work that are more — I hate to use the leftist word, "problematic." But in other words, the parts that are a bit challenging to us. I mean, if you read *Constitution of Liberty*, there are parts of it where you say — I mean, Rothbard just went nuts reading that book. There are parts of it that are very friendly towards state intervention. And even in *The Road to Serfdom*, which in my opinion I think is an overrated book, I'm sorry to say — or at the very least, today I think most of the warnings are not relevant anymore. They're mostly warnings about regimes that control the means of production, and we just don't have that anymore.

**SALERNO:** That's correct.

**WOODS:** So I actually am not a huge fan of that book. But in there, there are all kinds of concessions made in the spirit of, *But we all admit that such and such*, or, *Certainly there's no reason that there shouldn't be some basic level below which people shouldn't be allowed to sink*, or whatever and, *All reasonable think this*. It's just filled with stuff like that, so what are we — how do we deal with that? Or just put some meat on those bones there. What exactly is Hayek saying? I mean, Hoppe went so far as to call Hayek — did he call him a democratic socialist or some kind of thing like that?

**SALERNO:** Social democrat, he may have called him.

**WOODS:** Yeah, that may have been what it was.

**SALERNO:** Yeah, so what I would say is that Hayek definitely comes out in favor of government intervention, especially in *The Constitution of Liberty*, and if you read Mises' review, his review of the first two parts are very glowing, but the part on policy Mises takes a very dim view of it and says that it is supportive of the welfare state. In Hayek's defense — I'm not defending his position, but I'm defending maybe the reason why he did it, and this is just speculation: he wanted to be heard. He had disappeared as an economist after Keynes died. Once Keynes passed away, Hayek had said to his wife, *Now that Keynes is gone, I'm the most prominent economist in the world*. He says, *But ten days after Keynes died, everyone had forgotten about him because Keynes became a martyr. Keynes became a prophet*. So Hayek was very disappointed and moved away from economics because he saw the way that tides were turning against old-style, sound economics.

But anyway, to get to *The Constitution of Liberty*, he started to work on social theory and political philosophy, and I think he wanted a hearing. And whether we remember this or not — I mean, we didn't live it, but the 1950s, certainly the early '50s, late '40s, there was great sympathy for socialism, if not outright ownership of the means of production, but for socialism of many consumption goods, meaning things like nationalizing specific industries and so on. So Hayek I don't think wanted to put himself sort of athwart this movement, but he wanted to redirect it back towards the free market. So I think in that sense, he was a gradualist. And I think it was a mistake, because if you look at his stuff after 1975, he is again very combative. He's very pro-free enterprise. You see very little of his support for negative income programs that Friedman was supporting at the time and things like that.

**WOODS:** Now, I do want to at this point say something about "The Intellectuals and Socialism" essay, because this has become the rallying cry for a lot of different people, in which they argue that Hayek has laid out the correct way that ideas ought to be spread in society. And the version of what Hayek is saying that we get popularly runs something as follows: that if you want to have social change, you have to start with ideas, and if you want to start with ideas, you have to go right to the people who are the spreaders of ideas, namely the intellectuals. You've got to convince them, and if they get the ideas right, that will eventually permeate society and then things will change.

And some people have really run with that and used that to justify their own personal approaches to this kind of question, but there's nothing that's obvious about that to the point where it's beyond question. In fact, it's very much open to question. And of course this style would also be very opposed to, let's say, a more populist approach that short circuits the intellectuals and goes directly to the public and just tells them, *I'm not going to write you a 40-page policy report; I'm going to tell you you're getting ripped off by this group, this group, and this group in the government.*

**SALERNO:** Yes. That position was wrongly attributed to Hayek. In fact, that was the position developed in the late '70s by the people that were involved with IHS, notably Walter Grinder and Richard Fink.

**WOODS:** Now, IHS is —?

**SALERNO:** The Institute for Humane Studies, which still exists and ran many student programs back in the '70s and early '80s. And I was involved, and I remember when this position was being formulated, and it was called the intellectual structure of production. So it was a play on Hayek's material structure of production in producing goods.

And so what they did was to say, well, this is a pyramid of social change. So we have these experts and academics coming up with new ideas, but for some reason, they're incapable of spreading them directly to the populace, to the informed public. We need sort of a second and third layer. Second layer may be think-tanks that write policy reports that are accessible to more people. And then there's a third layer that I've seen them insert, and this is sort of lower-level intellectuals — the journalists, the publicists, writers of books, and so on — and including what they call actuators or high-level libertarian activists. So then they then sort of take the ideas and they make them palatable to the dumb-dumb public. I mean, that's how they view the public, as sort of passive and not too smart.

Hayek would have none of that. In fact, in Hayek's article, he argued that the intellectual class in the middle of that pyramid was totally unnecessary and that experts themselves could easily spread their ideas. He said that class developed sort of as a socialist-leaning class, that what they did was they weren't particularly good in any particular areas, an intellectual, but they were familiar with ideas because they were writers and speakers and so on. So what they did was to pick and choose ideas from academia that fit with their worldview, and their worldview tended to stress advanced, progressive, modern ideas. And so that's what they spoon-fed to the public.

So to give you a concrete example, remember in the 1960s the new economics of the Kennedy and Johnson economists. *Time* picked that up. *The New York Times* picked it up. Many parts of the establishment media picked that up and spoon-fed that to the public. Also Galbraith's ideas. But if you look at the same time in the 1960s and '70s, Friedman was writing directly for the public, short circuiting the intellectuals. So was Mises. So was Hayek.

So Hayek in fact in the book speculates about getting rid of this middle class, this middle level of intellectuals. And what he says is one way to do that is to get rid of copyright laws. He said, why should there be a class that lives on the earnings from their books? He said we should have an open discussion in society about copyright laws. In effect, he wanted to liquidate the intellectual class. So Hayek never in that article ever made any reference to an intellectual structure of production.

And in fact — and David Gordon put me on to this — ideas, once they're produced, new ideas aren't scarce anymore. They don't have to be produced anymore. The expert himself or herself, the person who's come up with the idea can communicate directly with the public. There is no necessity for an intellectual class. And Hayek says that, that there's no necessity for the intellectual class. And in that, he is like Mises. Rothbard once told me that, when they were talking about starting a graduate school at FEE and Mises would be the dean, Mises kept repeating, "But we must make sure that we give public lectures to businesspeople and to the lay public." And Rothbard never understood that until I sort of wrote an article on Mises in which I pointed out that Mises thought that the experts, the economists who knew what they were talking about, should write not only for other economists, but for the public themselves.

**WOODS:** So this idea then that we should be focused on — well, let's talk about the Mises Institute, then. Might as well. You're the academic vice president.

**SALERNO:** Yes.

**WOODS:** How is your view of the way ideas are most effectively spread reflected in how the Mises Institute runs its programs? I mean, it almost sounds like we set this up to be an infomercial for the Mises Institute, but I just thought of that, actually.

**SALERNO:** No, you're absolutely right. We have what's called the flat structure of production, which the people at IHS sort of look down on that. But we have experts, economists who have done research in Austrian economics and some have done very deep research, they come to our conferences for students — the Rothbard Graduate Seminar, for example, and the Mises University — and they talk directly to students. They give the results of their reading and research to the students. So we're following the Mises and the true Hayek path to disseminating ideas. Let's have the experts talk directly. We don't invite "intellectuals," meaning those people who aren't particularly expert in any area but are what Hayek called

second-handers in ideas. They look at other people's ideas and then they try to make them more accessible to the public. We feel that a good economist should be able to, like Mises, like Hayek, like Rothbard especially, to be able to directly communicate with the public. And for the most part, we have very good feedback from students on the way we do that.

**WOODS:** How is this related to the debate over populism as style?

**SALERNO:** Yes, well, there was a recent talk or speech given to the Mont Pelerin Society by Pete Boettke, who was the president back in November, in which he really badly confuses populism and nationalism. He attributes to populism the anti-immigration stance, anti-free trade stance, an inward-looking view. But populism is not an ideology in and of itself. There can be left populism. Look at Hugo Chavez and Maduro in Venezuela or look at the Perons. They were left-wing populists. And there are right-wing populists. So it's a strategy. It's a strategy that's aimed at getting rid of the entrenched elites that are in power. So it can also be used by libertarians. And I've written about this and I strongly think that it should be used by libertarians.

So now we come to nationalism. Nationalism is an ideology. However, there's two kinds of nationalism, which Pete Boettke confuses in his talk. There is what Mises called aggressive nationalism. This is where the state tries to expand the nation and focuses on its own view of what the nation is. Mises is against that. Mises talks about what he calls peaceful nationalism or liberal nationalism, which came about in history when the royal absolutism was in power, and the only way to oppose it was to get a large group of people to fight it. And for the most part, places like Italy and Greece and parts of Germany, they were ruled by people from other lands, kings from other lands. So nationalism was a way of forming a liberal movement. Every significant liberal movement has been national. And so what Mises points out is that once you've thrown off the yoke of despotism, at that point then the nation grows naturally.

But he was always in favor of national self-determination. So what he said was that if you have a number of nations now — that is, different peoples with different languages — in an area and they've thrown off royal despotism, you would still have a problem. There would still be the majority oppressing a minority, even with a liberal constitution. So Mises was in favor of national self-determination, which meant that the smaller linguistic or national groups should be able at any time to secede from the larger majority and form their own nations. So Mises saw two parts of the liberal program. One was domestic laissez faire, but the second was, even with that, that wasn't enough. You needed to allow national self-determination. And that wasn't from the top but from the bottom. People would self-identify with certain religions, certain languages, certain ancestors, and they would form a nation.

**WOODS:** Let's shift gears yet again, because there are so many aspects of Hayek to talk about. I actually want to just know what was Hayek's overall opinion of Mises. My impression is he had profound respect for Mises. He said tremendous things about him. But I think he did think Mises was either mistaken about some things or his attitude wasn't quite right. So what would be his full picture of Mises in a candid moment?

**SALERNO:** Well, after Mises passed away, there were a few candid moments in writing. He said that Mises was a child of the Enlightenment and never broke away from that — that is, that Mises' position that people rationally choose social institutions that benefit them — that is, to engage in peaceful trade and to be involved in market exchange that leads to a price system — he said that was wrong. He said people acted as sort of, I don't want to say the

puppets, but as the followers of rules and traditions and customs, and that it was sort of cultural selection so that the more successful groups that somehow hit upon the market economy, they then became those that grew and that prospered. And Mises sort of opposed that. Mises believed that it was a rational choice.

Now, what Hayek misunderstood about Mises was Mises wasn't saying that every individual conceives the entire market economy in some theoretical sense. That's what Hayek was sort of implying about Mises. What Mises was saying is that each individual immediately saw the benefits of exchanging with other individuals and specializing in things that they were best at producing, in things that they had the comparative advantage. Mises called that the law of association, that everyone produced those things that were least costly to them and then traded for things that were more valuable for them. And that was natural, but it was also rational, so that all that the market economy is, as Rothbard has told us, is a network of these voluntary exchanges.

Now, in the 17th and 18th century, individuals according to Mises, certain individuals began to conceptualize how this would work: Adam Smith, a British classical economist; Bastiat. And so that he called economics and liberalism an account of the unfolding of human society, that the social order unfolded and that, once we saw that happening, the brighter people, those that had a bent towards intellectual conception, wrote books on economics. So that then did reinforce the market economy in the sense that then the informed public could understand the implications of what they were doing. But in order to have a market economy, you don't have to have economists first explaining it to people, which Hayek sort of believes, that there's this sort of blind following of rules and so on and it's good for the intellectuals to – or actually, for the experts. He wouldn't use "intellectuals – for the experts to write about this and to explain it later on.

**WOODS:** Well, Joe, after we've covered all these topics and now that we're on to Hayek and Mises, dare I ask the favor of maybe your summarizing what you had to say in your article that I read all those years ago about Mises as social rationalist? Because you're hitting on that here and it has something to do with the different ways that Hayek and Mises conceived of the problem with socialism. Because when you hear Hayek talk about it, he uses the word "knowledge" a lot, and then people who follow Hayek, they talk about a knowledge problem and no planner could know everything he needs to know. And I think until you teased it out, it wasn't completely clear to everybody that Mises was saying something rather different from that.

**SALERNO:** Yes. What Mises was saying was that, even if you had all of the knowledge that you needed, even if you knew all the resources, the latest state of technology, and somehow consumer preferences, or if you were a planner that substituted your own preferences, there are so many diverse goods and there are so many different ways of combining goods in a modern economy, combining of resources to produce different quantities of different goods, it's almost an infinite number of ways of using the resources in the economy. So it's not enough to know what exists in the economy.

What Mises said was that you needed an intellectual – what he called an intellectual division of labor. And what he meant by that was that there has to be entrepreneurs who are speculating on what consumers will want in the future using prices. So Steve Jobs would speculate on what price that he thinks consumers would pay for Mac computers. They had never been produced before, but he had some idea of the demand for them and he would



speculate. And then he and other entrepreneurs would bid for the labor and the materials necessary to produce all of the goods in society. So out of this bidding for labor and so on what would happen is there would be a price system. Every single unit of every single type of resource in society and every type of labor and capital good and factory would have a price so that you could always compare the cost of what you were doing to the expected price of the product.

So for Mises, calculation was the main benefit of the market economy that allowed orderly production and production according to what consumers wanted. Knowledge was not enough. No entrepreneur every knew everything, but even if he or she did and even if a planner knew everything, they couldn't combine resources in a way that was efficient because they wouldn't know the cost. They wouldn't know what they were giving up.

So if you were producing a car in a capitalist economy, you know that this new car that's going to be a super-fast car with a battery might cost you \$90,000, because you know the prices of all the materials that you need to combine to get this automobile. So you would then compare that to what people would be willing to pay. If they'd be willing to pay \$100,000, then you should produce the car because that's the best use of those resources. But a planner would never know that. The planner could produce the car. They'd have the technological knowledge. But they would never know if they were giving up things that consumers valued more. So prices and calculation, calculating your costs and your profits using market prices would always allow you to know if you're wasting resources by producing something that has a lower value than could have been produced. So that was Mises's point.

**WOODS:** All right, well, with that we'll wrap up for today. And I'm going to have a bunch of readings. We'll have the readings you recommended from Hayek. I'll put your essay on Mises as social rationalist up there. We'll get a lot of good stuff up at [TomWoods.com/1082](http://TomWoods.com/1082). Of course everybody should be visiting the Mises Institute at [Mises.org](http://Mises.org). And in fact, if they visit [Mises.org](http://Mises.org), I may never hear from them again because there's so much there you could easily just spend the rest of your life on that website. But Joe, thanks so much for your expertise on this question.

**SALERNO:** Tom, it was my pleasure and thanks for all the great questions.