

Hayek's Challenge: An Intellectual Biography. By *Bruce Caldwell*. Chicago: University of Chicago Press, 2004. xi + 489 pp. Appendix, bibliography, index, notes. Cloth, \$55.00. ISBN: 0-226-09191-0.

Reviewed by Meghnad Desai

Friedrich Hayek was a giant of twentieth-century economics and, besides John Maynard Keynes, the most influential. Keynes's ideas dominated economic policy between, say, 1945 and 1975. Hayek took over at that time and transformed the nature of our ideas about the role of public policy. Keynes was predominantly an applied economist whose foray into theory was outstandingly successful. He dabbled in social philosophy and biography. Hayek started as a theorist and stayed one. But halfway into his long life of ninety-three years, he gave up economics and turned to political philosophy. His influence on economic thinking thus came in the wake of his defense of libertarianism, but the ideas that gained currency in the 1970s and 1980s were formulated in the 1930s, when Hayek fought a losing battle against Keynes.

Yet Keynes is easy to deal with, despite the atrocious style of his magnum opus, *The General Theory of Employment, Interest and Money*. Hayek's oeuvre spans sixty-plus years. By the time he was forty-five he had tackled the economics of money, capital, and business cycles and the socialist economic calculus, before undertaking a methodological attack on Léon Walras's equilibrium theorizing and displacing it with an innovative theory of knowledge. Then he launched his program, entitled "The Abuse of Reason," which was a critique of scientism, an attack on the fashion for dirigisme in his *Road to Serfdom*, a treatise on psychology, and the monumental *Constitution of Liberty*, followed by a three-volume treatise on *Law, Legislation, and Liberty*. By this time he was eighty years old. He got his Nobel Prize in 1974, when many thought he had died long ago, yet that was when his influence began to ascend. By the time he died in 1992, he had become a revered guru of the radical Right, acknowledged as such by Margaret Thatcher and Ronald Reagan.

Bruce Caldwell quite rightly sees writing about Hayek as a challenge. But he is most fitted for the task. He is the editor of Hayek's *Collected Works*, the latest and I have no doubt the best of a series of editors of that project. He has written on methodology in the past and is well versed in the history of economic ideas. He begins this book with a long background section on Austrian economics, starting with Carl Menger and the *methodenstreit* of the German Historical School, which occupied so many in the last quarter of the nineteenth century. This is important, because although Menger is bracketed with Walras and William Stanley Jevons as part of the Holy Trinity of marginalism, his approach is much more subjective and a priori. Austrians do economics very differently from the rest of economists. Joseph Schumpeter, as one product of Vienna, was thought to have escaped their influence, becoming eclectic in his methodology. Hayek was to stay within its fold and challenge a lot of received wisdom.

In the second part, Caldwell takes up Hayek's career. Here we have a biography of the early years, followed by an account of the major themes in Hayek's writing. Thus Caldwell begins with Hayek's extensive work on money, capital, and business cycles. It is forgotten nowadays how important Hayek's contribution was to the debate on the nature of the business cycle in the 1930s. Paul Sweezy, fresh out of Harvard and a Marxist, came to the London School of Economics to sit at Hayek's feet because he had been told that Hayek had the key to capitalism. Hayek wrote four books between 1928 and 1941, and yet either the key eluded him or they had changed the lock. The moment belonged to Keynes, with whom Hayek had battled through the 1930s. Hayek abandoned his program of business-cycle research.

There were other debates, such as the one with Oscar Lange on socialist economic calculation; again at that time people thought Lange had won. Another forty years elapsed before Hayek's truth was understood and socialist economies began to fall apart. Hayek's mistake in the debate was to say that a socialist planner could not possibly solve all the price equations.

This was because he was still seeing the economy through Walrasian eyes. It was some time before he realized that the Walrasian model of static equations in simultaneous markets had less to do with the dynamic system that capitalism was

and more to do with the kind of mathematical economics Lange was using to show that markets and planning were similar.

So Hayek came to his most innovative idea. His 1937 essay, “Economics and Knowledge,” is probably the most original piece of economic theorizing of the twentieth century. Nothing in the previous theories prepares us for this. He saw that capitalism—or a market economy if you will—is a search process, in which knowledge is distributed across market participants and the required pooling of knowledge happens and can happen only continuously in the process of market participation by the agents and hence cannot be grasped in its entirety by any single agent or even by a planning commission. The strategies of individuals based on their own local knowledge and subjective expectations have to cohere, even if only for an instant, if the market is “to clear.” You can call this equilibrium if you like, but it lasts merely for an instant.

This insight led to the creation of a research program very different from Walrasian or neoclassical economics. In 1945, Hayek ventured the idea that the price system was one such pooling device, but I see this as detracting from the originality of the 1937 idea. Caldwell is much concerned with 1937 as an epistemological break in Hayek’s early engagement with Ludwig von Mises and his *a priori*ism. In my opinion, Hayek had wandered away from Vienna into Lausanne territory, and he only returned to Menger’s insights in 1937. Once he had done so, a lot of Walrasian equilibrium theorizing seemed irrelevant. Unfortunately he did not pursue economics after that, but instead veered off into an investigation of the philosophical foundations of a free society, which consumed the thirty five years from 1945 to 1980.

Caldwell covers these years well, and in the last part he assesses Hayek’s legacies and offers his own thoughts on twentieth-century economics. For the readers of this journal, Hayek’s importance lies in his demonstration that the neoclassical, or Walrasian, theory of markets had nothing whatever to do with real markets. It is inadequate for examining historical processes, and while the pursuit of this theory visited cliometrics upon long-suffering historians, its utility was limited. But since Hayek and the Austrians did not replace neoclassical economics with an alternative

worked-out paradigm—they were philosophically against such a project in the first place—we are left with a lot of insights into dynamic disequilibrium of search processes and discoveries.

But Hayek's life also illustrates the importance of taking ideas seriously, whether they are in fashion or not. He had the courage to dig deeply into the philosophical basis of his belief in liberty. He took fifteen years out of his busy life, when he could have stayed at the top of the economics profession. His long detour took thirty-five years, but at the end he was taken seriously. The ideas he had in the 1930s about the nature of cycles in capitalism came back to haunt the Keynesians. He saw the demise of socialism fifty years before it came about. Caldwell's book is a good place to start with if you want to understand or even emulate Hayek.

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