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EE 460: Friedrich Hayek

A) His life

Friedrich August von Hayek is born in Vienna (Austria) the 8th May 1899, eldest from a family of 3 children, his dad was a university professor and later a prominent civil servant. Her mother was a wealthy and conservative woman. Scholar since is youngest age, he knew how to read and write before going to school.

In 1917, at the age of 18, he took part in world war I in the Austro-Hungarian Army in an artillery regiment. He even has been decorated for his bravery.

This part of his life, in addition to be part of a highly educated family, has been decisive in his decision to pursue an academic career.

He started to study in the university of Vienna where he got a first doctorate in law in 1921, followed by a second one in political science in 1923. He also studied psychology. Then, he worked as research assistant for the New York University for 1 year before becoming director of the Austrian Institute for Business Cycle Research. Finally, he joined the famous faculty of the London School of Economics (LSE) and decided to stay there to avoid returning to Austria who had been annexed by the Nazi Germany. He became a British citizen in 1938. In 1950, he left the LSE to work for the university of Chicago where he met other prominent economists such as Milton Friedman. Finally, from 1962 until his retirement in 1968, Hayek was a professor at the University of Freiburg (Germany). After that, he continued to write actively before dying at the age of 92, the 23rd March 1992.

In a nutshell, Hayek, through is life, met a lot of intellectuals who influenced his life. As an intellectual himself, he contributed to several disciplines such as economics, philosophy, psychology and social sciences. At the same time, he was seen as marginal from lot of intellectuals because of his clear liberal position in opposition with the dominant social position at that time. Especially in opposition with the Keynesianism who dominated the economics profession until the stagflation during the 70's ("condition of slow economic growth and relatively high unemployment – economic stagnation – accompanied by rising prices, or inflation, or inflation and a decline in Gross Domestic Product (GDP)" (Investopedia))

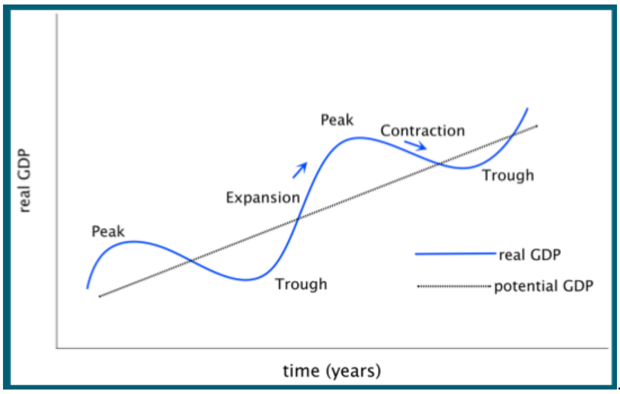
B) some of his most important works and contributions

- **Economic booms and busts**

For Hayek, when the government interferes into the economy it results in people not acting in a sustainable way, this lead to booms but also to busts. Indeed, those interferences change people behaviors by changing incentives and signals in the market. The issue is that it leads to changing investments which ultimately leads to boom or busts.

More specifically, monetary injections from the government lower the rate of interest below the "natural rate", which distort the economy's structure of production. This lower rate of interest lengthen the period of production because consumers change their preferences to favor future over present consumption. This "false signal" create a boom due to the increase in investment. When market participants realize that they don't have enough saving to complete all new projects, the boom turns to a bust. The recovery from the bust to the boom consist of liquidating all those "malinvestments".

This idea is in opposition with Keynes' thoughts that governments should increase spending. Indeed, for him, those spending would increase aggregate demand.



(source : https://suvaneconib.wordpress.com/2010/04/30/fear-the-boom-and-bust/)

This theory has been studied In *Prices and Production* (1931) and *Monetary Theory and the Trade Cycle* (1933).

- **Spontaneous order**

This idea has emerged during the XVIII century with B. Mandeville, D. Hume, A. Ferguson and A. Smith famous for his theory of the invisible hand.

The idea is that an order which emerges as result of the voluntary activities of individuals and not one which is created by a government. This is a key idea in the classical liberal.

Hayek claimed that the efficient exchange and use of resources can only be maintained through the price mechanism in free markets.

For this theory came the word "catallaxy" which is a "self-organizing system of voluntary co-operation." (Hayek 1945)

Those 2 contributions give a good idea of Hayek point of view. As said at the beginning of this report, he also contributed in many field, we could, for example, quote his book "the sensory order" which is considered as a major contribution to psychology but we won't go further.

On the 9th October 1974, Hayek has been awarded by the Nobel Prize in Economics "for their pioneering work in the theory of money and economic fluctuations and for their penetrating analysis of the interdependence of economic, social and institutional phenomena"" (*Nobelprize.org*. Nobel Media AB 2014)

Has a legacy, we know that he has heavily influenced Margaret Thatcher's economic approach as well as some of Ronald Reagan's economic advisors.

C) Hayek versus Keynes

As we saw before, Hayek and Keynes are firmly different. The table below gives Hayek's point of view as well as a quick overview about Keynes ideas.

	Hayek	**Keynes**
Way of thinking	Liberal	Interventionism
Full employment	Automatic	Non-automatic, the government has to intervene (possibility to have an under-employment equilibrium)
Explanation of the 30's crisis	Overinvestment and lenient monetary policy	Not enough investment
How would they explain the 2008 crisis?	Lenient monetary policy which promotes credits (= bad incentives)	Financial misuse (speculation, too much power, not enough control)
How to get out of a crisis?	Let the market do the job	Governments have to intervene to relaunch consumption & investments

Recommended video: https://www.youtube.com/watch?v=d0nERTFo-Sk (Fear the Boom and Bust": Keynes vs. Hayek Rap Battle)

D) Conclusion

The wrap up this work, we see that the economy balanced between those two ways of thinking. Nowadays, it seems that most economies are more mitigated and try to comply with both of it. Indeed, we see that most governments offer a great liberty in the economy and don't intervene that much. However, they do intervene to avoid systemic crisis but as we saw in 2008, the system isn't perfect and crisis still can occur, which shows the complexity of the modern economy.

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