

The Argument Between Keynes and Hayek: Economic or Philosophical?

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Abstract:

The feud between Keynes and Hayek in the early twentieth century has long been regarded as a significant clash in the field of economics. Enormous scholarship has been dedicated to analysing the origins and consequences of the argument in economic studies. However, upon reading and reflecting on their writings, this essay argues that the ultimate reason for their disagreements lies not in their divergent preferences for economic policies, but in their fundamentally different philosophical holdings.

Keywords / Klíčová slova:

Keynes – Hayek – Economic History – 20th Century – Intellectual History
Keynes – Hayek – Ekonomické dějiny – 20. století – Intelektuální dějiny

The argument between J.M. Keynes and F.A. Hayek, which started since their first theoretical clash at the 1929 conference held by the London and Cambridge Economic Service, is a famous debate in economic history, even termed by Nicholas Wapshott as ‘the clash that defined modern economics’.¹ Some scholars argue that the differences in opinion between the two are so shallow that they could be offset by their shared identity as liberals.² This essay disagrees with the perspective; instead, it argues that their differences are epistemological and philosophical. Firstly, it seeks to prove that the ‘principle organic unity’ insisted by Keynes and Hayek’s individualism are incompatible; then it will examine their distinguished conceptualization of time in theories; and finally, the essay will turn to analyze their different policy recommendations on governmental roles. Overall, Keynes was writing as a politician, while Hayek was arguing as a historian. The focus of this essay will be on the arguments between the two titan economists in the 1930s.

Trained as a philosopher, Keynes was largely influenced by his study of J.E. Moore’s philosophical thoughts, especially the principle of ‘organic unity’.³ Moore explicitly asserted in his book, that ‘The value of the whole must not be

1 Friedrich A. von. HAYEK, *Contra Keynes and Cambridge: Essays, Correspondence*, London 1995, p. 59; Nicholas. WAPSHOTT, *Keynes Hayek: The Clash that Defined Modern Economics*, New York, London 2011, p. 1.

2 Bruce CALDWELL, *Hayek: A Life, 1899–1950*, Chicago 2023, pp. 291–300.

3 Gordon FLETCHER, *Understanding Dennis Robertson: The Man and His Work*, Cheltenham 2000, p. 325.

assumed to be the same as the sum of the values of the parts.⁴ The effects on Keynes was so long-lasting that in 1938, when Keynes was reading out *My Early Beliefs* to his Memoir Bar audience, he still incorporated the principle into his speech: 'Nothing but the states of mind matters...their value depended in accordance with the principle of organic unity on the state of affairs as a whole which cannot be usefully analyzed into parts.'⁵ The reception of this principle has left a significant mark on Keynes' economic thoughts. Instead of focusing on the behaviors of economic man as an abstract unit, as the classic economists did, he instead emphasized aggregate forces.⁶ For example, the key concept in The General Theory, the Marginal Efficiency of Capital (the prospective yield of the investment divided by the current supply price of the capital asset) is largely influenced by people's expectations of the future and their evaluations of risks.⁷ In Chapter XII, when Keynes was analyzing the functioning of financial markets, individual investors appeared as members of a group holding different expectations. It was not the differences between, but the uniformity of and the relative balance or imbalance of the agents that mattered.⁸ In other words, the market was analyzed as a statistical whole defined by conventional forces.⁹ Liquidity preference, another crucial concept in Keynes' theory, which is defined as the strength of people's desires to hold wealth in liquid or illiquid forms respectively, is said to be influenced by three purposes, namely the transactive (the purpose of day-to-day purchases), speculative (the purpose of securing profit from better knowledge of the future), and precautionary (the purpose of security).¹⁰ The interactions among the three purposes concern the balance or imbalance of the forces of different groups of people's expectations, which can never be fully grasped by analyzing the individuals separately. Plus, the famous paradox of thrift, which characterizes the dislocation between individual choices and societal goodness also illustrates the principle of 'organic unity'.¹¹ A rational decision for an individual household to save during tough times is a real drawback for the entire economy, and thus the latter cannot be simply viewed as the sum of the former.

Arguably, many of Keynes' macroeconomic ideas can be traced to the philosophical principle of organic unity. However, that is a thinking pattern completely unacceptable for Hayek. His subscription to the Austrian school, which is known

4 George Edward MOORE, *Principia Ethica*, Cambridge 1903, p. 28.

5 G. FLETCHER, *Understanding Dennis Robertson*, p. 324.

6 Teodoro Dario TOGATI, *Keynes as the Einstein of Economic Theory*, History of Political Economy 33, 2001, p. 125.

7 John Maynard KEYNES, *The General Theory of Employment, Interest and Money*, Cham 2018, p. 120.

8 Ibid, pp. 132–5.

9 Ibid, pp. 132–5.

10 Richard KAHN, *The Making of Keynes' General Theory*, Cambridge 1984, p. 139.

11 G. FLETCHER, *Understanding Dennis Robertson*, p. 329.

for the insistence on individual subjectivism, is fundamentally incompatible with Keynes' aggregate thinking.¹² According to Fritz Machlup, it could be a result of the Austrian school's interaction with Georg Simmel, whose *Philosophy of Money* condemns the effects of eliminating individual value differences through standardized currencies.¹³ Simmel's subscription to subjectivist individualism is evident in his condemnation of the liberty afforded by the monetary economy to judge people solely by their financial achievements evaluated by the number of dollars in their account, rather than through personal interactions.¹⁴ Following the Austrian tradition, Hayek's analysis of economic function began with the choices of purposeful individual agents, of 'acting man', while many social phenomena were examples of spontaneous orders, namely the unintended consequences of purposeful individual choices.¹⁵ Also, the Austrian subjectivism manifests itself in their treatment of the concept of 'utility', which rests not on any objective criterion but on individuals' subjective satisfaction with the products.¹⁶ This definition further rules out harmony with Keynes, because the lack of more objective standards makes it almost impossible to approach the economy holistically or aggregately. Therefore, whereas Keynes embraced the philosophical concept of the 'organic unity', Hayek insisted on adopting the Austrian individualist approach. Their differences in economic theories; are actually backed by more fundamental differences in philosophical guidance.

The second philosophical difference between Keynes and Hayek lies in their different conceptualization of time. Vol. IX of the collected works of Hayek collects his aggressive comments against Keynes, where he fiercely attacked Keynes's excessive focus on short-term economic performances at the expense of long-run considerations. This accusation reflects their fundamentally different treatment of 'time' in their theories. In Hayek's works, time is an absolute being, while in Keynes' works, time is relative to history (human lives). Hayek's Stage Theory regards the production process as a series of sequential stages, starting with early-stage activities (less capital-intensive, such as mining or farming) and ending with the manufacture of consumer goods (more capital-intensive).¹⁷ The cause of the downturn in trade cycle experienced by the world in the 1930s, was interpreted as the consequence of the irresponsible expansion of credits by banks, which drove the market interest rates below the natural rate.¹⁸ The economic booms generated

12 Israel M. KIRZNER, *Ludwig von Mises: The man and his economics*, Washington, D.C. 2023, p. 6.

13 Georg SIMMEL, *The Philosophy of Money*, New York 2011, p. 89.

14 G. SIMMEL, *The Philosophy of Money*, p. 89.

15 Bruce CALDWELL, *Hayek and the Austrian Tradition*, in: E. FESER (ed.), *The Cambridge Companion to Hayek*, Cambridge 2007, p. 29.

16 B. CALDWELL, *Hayek and the Austrian Tradition*, p. 29.

17 Friedrich A. von HAYEK, *The Pure Theory of Capital*, Chicago 1941, pp. 49–71.

18 F. A. HAYEK, *The Pure Theory of Capital*, pp. 49–71.

by the artificially lowered rates were displaying unsustainable production patterns which would finally become busts. Sticking to long-termism, Hayek conceptualized 'time' as an absolute term, relative to nothing. The classic visualization of his stage theory (Figure 1 in the Appendix) makes no distinction between time in the past, at present, or in the future, as long as the time was, or is, to be stored in the value of the final products when fruited and redeemed as utilities by consumers in the end. The time is represented in the triangle as standardized units or 'productive currencies' without historical relevance. The standardization is probably the natural result of his insistence on long-termism, because the infinity of time indeed softens historical fluctuations and short-term irregularities, just as satellite photos of Earth eliminate the undulating mountains of the landforms. Such a bird-view perspective of time may find its ultimate inspiration in the Austrian philosophy of chronological equality: time passes without differences in significance, and thus any of today's problems cannot be solved at the expense of tomorrow. Hayek was pronouncing the long-term diagnosis of economic diseases with one assumption: human beings will live to witness the day when the market finally corrects the failure by itself. As an economist subscribed to long-termism, Hayek's time is an absolute and infinite concept that belongs only to the omnipresent and omnipotent.

Keynes's conceptualization of time presents a sharp contrast with Hayek's. Apparently, Keynes' time is a relative, historical and contingent concept. Just as, and probably influenced by Einstein's doubts on the absolute simultaneity, Keynes doubted the chronological equality.¹⁹ One of his own quotes really captures the essence of this doubt: in the long run, we are all dead.²⁰ As Patinkin contends, though there might exist forces that would bring the economy back to full employment equilibrium, these might be very weak or operate very slowly.²¹ It might be correct to say that time is infinite, but the time of history is finite. Time, for the purpose of human lives, is thus not an absolute being. It is only after people have lived through it that it becomes real and meaningful in history; otherwise it merely exists in imagination. For Keynes, it is an easy fact that the economy may take seven years to recover, but people will die in seven days if they are starving. The weight of the seven days in the second scenario, due to its bearing on the significance of human lives, is then heavier than a random seven-day period in the first scenario. Death marks the end of the meaningful time of a person's life. Keynes was well aware of this fact as early as his study of Moore, whose philosophy had no place for the afterlife or rewards in Heaven.²² Therefore, in Keynes' theory, adopting active short-term measures to address certain economic emergencies is justifiable on the grounds of

19 T. D. Togati, *Keynes as the Einstein of Economic Theory*, p. 127.

20 John Maynard KEYNES, *A Tract on Monetary Reform*, London 1923, p. 80.

21 Roger BACKHOUSE, *The Keynesian Revolution*, in: Roger BACKHOUSE & Bradley W. BATEMAN (eds) *The Cambridge Companion to Keynes*, Cambridge 2006, p. 26.

22 G. FLETCHER, *Understanding Dennis Robertson*, p. 323.

time's relativity. It seemed that their different approaches to the conceptualization of time had led Hayek to accuse Keynes of being the twentieth-century Louis XV, whose famous dictum 'after me, flood' had been understood or misunderstood to mean prioritizing current prosperity over posterity's welfare, and Keynes probably would respond by saying: 'what if we do not have a posterity?'

Hayek's *expectations* on the government's role in addressing economic difficulties were minimal and simple: keep the interest rates clean and clear. Interest rates, as proposed by the Austrian school, reflect a community's time preference between present and future consumption, and thus influence the choices between capital and consumer goods.²³ Economic actors learned through their activities to read the signals given by interest rates: a low interest rate indicates a low time preference for present over future consumption, which encourages investments in more capital-intensive forms that will take longer to bring to fruition, and vice versa. In effect, fixed capital is the accumulation of production over time, mediated by interest rates.²⁴ Therefore, any artificial alterations of interest rates will give incorrect signals to the economic actors and lead to disastrous consequences in the future. Waiting patiently is then his only advice.²⁵ Imaginably, Keynes had completely different views on governmental interventions. For him, the dominant influence on capital investment formation is the MEC, which is largely dependent on the psychological factors such as expectations.²⁶ In an open letter addressed to President Roosevelt published in *New York Times*, he wrote that 'Individuals must be induced to spend more out of their incomes; or in the business world must be induced, either by increased confidence in the prospects or by a lower rate of interest, to create additional current incomes in the hands of their employees, which is what happens when either the working or the fixed capital of the country is being increased; or public authority must be called in aid to create additional current incomes through the expenditure of borrowed or printed money.'²⁷ In a nutshell, Keynes supported expansionary fiscal and monetary policies in difficult times to restore people's confidence about the future in order to boost the economy. He further explained his idea in the *General Theory*, where he named three areas for government expenditure: housing, transportation, and energy, since the three represented fixed capital rather than sunk costs, i.e., the investment required to get the plant ready for startup.²⁸ He also crystalized his definition of interest rates, which, contrary to Hayek, bore no real forces of productivity or thrift. Interest rates, according to

23 Martin CHICK, *Changing Times: economics, policies, and resource allocation in Britain since 1951*, Oxford 2020, p. 33.

24 Ibid, p. 33.

25 Ibid, p. 33.

26 Ibid, p. 33.

27 John Maynard KEYNES, *An Open Letter to President Roosevelt*, New York Times, December 31, 1933.

28 J. M. KEYNES, *The General Theory*, p. 287.

Keynes, represent the reward for parting with liquidity for a given period, and are a monetary phenomenon reflecting the conditions of money demand and supply.²⁹ Given the rigid wage-level and the disastrous economic circumstances at that time, Keynes proposed that the government could, by lowering interest rates and increasing spending on fixed capital, actively pursue a role in economic management, mitigating the 'uncontrollable and disobedient psychology of the business world' to induce people into consumption and investment.³⁰ Applying the principle of organic unity, Keynes argued that the socialization effects of investment cannot be neglected when calculating the aggregate demand (the sum of consumption, investment, government spending and net export), since the psychological impacts of government spending on people's expectations on the future could generate the multiplier effects, i.e., a positive cycle of confidence that will revive the MEC and boost the economy as a whole.³¹ In Chapter 24 of his *The General Theory*, he expressly states that by 'socialization effects of investment', he means the State will have to 'exercise a guiding influence' through investment, which proves to be 'the only means of securing an approximation to full employment'.³² Evidently, the divergence between the two economists in their respective policy recommendations reflects their fundamentally different philosophical holdings. Hayek suggested that all government can do was to wait for the market interest rates to naturally converge with the natural rates because he considered the economic situation and capital stock as the intended or unintended consequences of individual choices instead of an organic entirety, and he believed that people will live to witness the day when the invisible hand finally correct everything in the forthcoming infinite future. Keynes recommended that the government actively engage in economic management by lowering interest rates or expanding fiscal policies, because he applied his principle of 'organic unity' and his concerns on earthly short-term realities.

Overall, this essay argues that the arguments between Keynes and Hayek reflect their fundamental, philosophical and epistemological differences. The passive approach proposed by Hayek to address the 1930s economic difficulties demonstrates his insistence on individualism and long-termism, whereas the active interventions suggested by Keynes indicate his subscription to the principle of organic unity and short-termism. The nature of their arguments is thus philosophical. Nonetheless, it is worth noting that neither of the two would be satisfied with the massive nationalization of industries that took place in the postwar years. No matter how incompatible their economic interpretations were, they converged in their shared identity as economic thinkers. The rapidly expanding state ownership

29 Ibid, p. 147.

30 Ibid, p. 282.

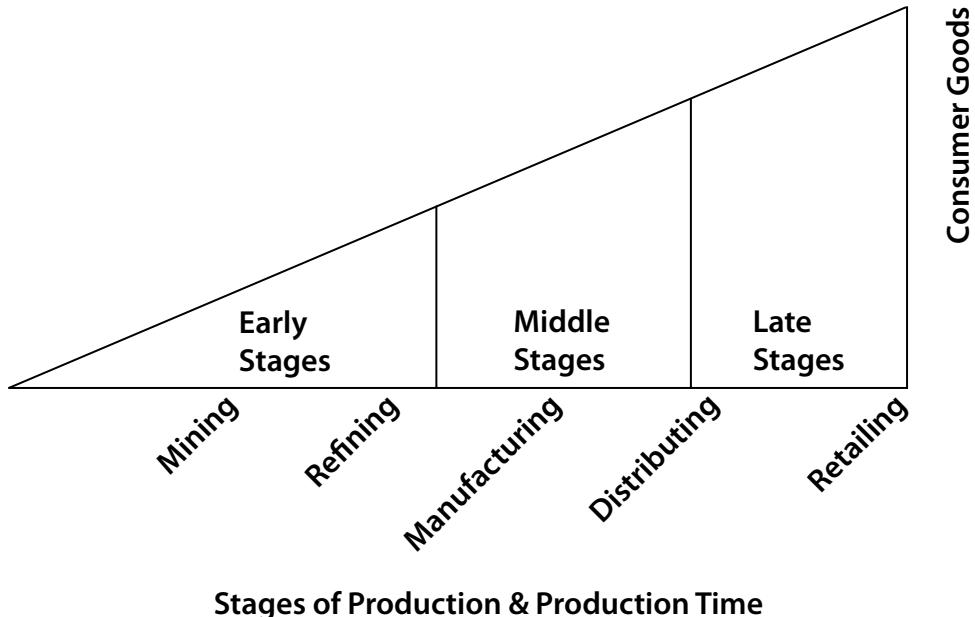
31 Ibid, p. 336.

32 Ibid, p. 336.

of production in the postwar years, which represented the enslavement of politics over economics, would be an unwelcome phenomenon for both of them.

Appendix

Figure 1. Triangle Representation of Hayek's Stage Theory.



Resumé:

The iconic intellectual feud between John Maynard Keynes and Friedrich Hayek in the early twentieth century has traditionally been analysed through the lens of competing economic theories and policy prescriptions. While extensive scholarship has examined their conflicting approaches to market intervention, monetary policy, and the government's role in economic stabilization, this essay argues that their disagreements stem from more fundamental philosophical divergences rather than merely differing economic preferences.

At the core of their intellectual divide lie contrasting philosophical foundations. Keynes was profoundly influenced by G.E. Moore's philosophy of organic unity, which shaped his holistic view of economic systems as integrated wholes in which collective actions could produce outcomes greater than the sum of individual parts. In contrast, Hayek's thinking was anchored in Austrian individualism, emphasizing the primacy of individual knowledge, actions, and their spontaneous coordination through market mechanisms.

Their conceptualizations of time further illuminated these philosophical differences. Keynes approached time as inherently historical and contextual, where economic decisions occur within specific historical moments that cannot be abstracted from their circumstances.

Hayek, conversely, conceived of time as an abstract framework in which market processes unfold according to universal principles, irrespective of historical contingencies.

These philosophical distinctions manifested in their competing policy prescriptions during the economic crises of the 1930s. Keynes advocated for active government intervention, seeing economic downturns as systemic failures that require collective action in their historical context. Hayek warned against intervention, believing that market processes, if allowed to operate freely, would correct imbalances through the dispersed knowledge of individual actors.

This analysis reveals that the Keynes–Hayek debate transcended economics, representing a clash between fundamentally different worldviews about human society, knowledge, and the nature of time itself—philosophical differences that continue to shape economic and political discourse into the present day.

Conger Wang is a third year student of History Department, HCA College, University of Edinburgh. The author's research focuses on the history of emotions and intellectual history in the modern era, and she is particularly interested in comparative studies between East Asia and Western Europe.