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Gold & Silver Newsletter

Monex International presents an exclusive interview with

Nobel Laureate Dr. Friedrich A. von Hayek

Photo by Ted Russell / Courtesy George Koether

This month the Gold & Silver Newsletter is privileged to present our exclusive interview with Nobel Prize-winning economist Dr. Friedrich A. von Hayek, who is recognized as the dean of the Austrian school of economics. Dr. Hayek is an internationally known theorist, author, teacher, and lecturer. He is interdisciplinary and has made important contributions not only in economics, but also in political science, philosophy, law, history, psychology, and the social sciences. In our wide-ranging interview, Dr. Hayek gives his views on the economy, unemployment, depression, likely future economic developments, and investments appropriate to those conditions. He also tells how he was able to forecast the 1929 crash and gives some personal—and surprising—insights about the British economist John Maynard Keynes.

Dr. Hayek was born on May 8, 1899, in Vienna. He served as an officer in World War I and afterward studied at the University of Vienna where he became a Doctor of Law in 1921 and a Doctor of Political and Social Science in 1925. After a few years in civil service in Austria, he became the first director of the Austrian Institute of Economic Research in 1927.

In 1931, he was appointed to a chair at the London School of Economics and Political Science and was later awarded a degree of Doctor of Science in Economics there. In 1950, he became Professor of Social and Moral Sciences at the University of Chicago. Following his retirement from the University of Chicago, he became Professor of Economic Policy at the Albert-Ludwigs-University of Freiburg, Germany. He currently resides in Salzburg, Austria. He is also Professor Emeritus of the Freiburg University and the University of Chicago, a Fellow of the British Academy, and an Honorary Doctor of Rikkyo University in Tokyo.

Dr. Hayek's many books include Prices and Production *(1931),* Monetary Theory and the Trade Cycle *(1933),* Collectivist Economic Planning *(1935),* Individualism and Economic Order *(1949),* The Sensory Order *(1952),* The Counterrevolution of Science *(1955), and his monumental work,* The Constitution of Liberty *(1960). He is currently writing a trilogy on political science,* Law, Legislation, and Liberty. *The first volume,* Rules and Order, *was published in 1973, and he is presently writing the second volume,* The Mirage of Social Justice.

His most widely known book is The Road to Serfdom, *which he wrote in London in 1944 in favor of a free market economy and in opposition to Keynesian-socialist arguments that a government-planned economy is the best economy. The main thesis of the book is that government central planning was not only less effective than a free market economy, but also would lead inevitably to totalitarianism. The book, which was a best seller in both the U.S. and England, has been translated into 12 other languages.*

Dr. Hayek's many contributions to economic understanding were recognized last October when the Royal Swedish Academy of Sciences awarded the

Hayek to speak at symposium

Dr. Hayek will be one of the participating speakers in the Monex-sponsored educational symposium on the economy this month in Beverly Hills. Details are on Page 6.

1974 Nobel Memorial Prize in Economic Science to Dr. Hayek and Dr. Gunnar Myrdal. We interviewed Dr. Hayek in April at his suite at the Waldorf-Astoria Hotel in New York City during his current visit to the U.S.

MONEX: First of all, Dr. Hayek, let us congratulate you on receiving the Nobel Prize.

HAYEK: Well, thank you. I had not expected it, but, of course, I was honored at having been chosen. I must say, however, that the demands on my time since then by the press and others has been astonishing. I'm beginning to think that the Nobel Prize is designed to prevent anyone who gets it from doing any further work.

MONEX: Our first question deals with your forecast in the 1920s that America was headed for a depression. We understand you were one of the only economists to do so. Is that true?

HAYEK: Yes. I was one of the only ones to predict what was going to happen. In early 1929, when I made this forecast, I was living in Europe which was then going through a period of depression. I said that there's no hope of a recovery in Europe until interest rates fell, and interest rates would not fall until the American boom collapses, which I said, was likely to happen within the next few months.

"You cannot indefinitely maintain an inflationary boom."

MONEX: How were you able to foresee what would happen?

HAYEK: What made me expect this, of course, is one of my main theoretical beliefs that you cannot indefinitely maintain an inflationary boom. Such a boom creates all kinds of artificial jobs that might keep going for a fairly long time but sooner or later must collapse. Also, I was convinced that after 1927, when the Federal Reserve made an attempt to stave off a collapse by credit expansion, the boom had become a typically inflationary one.

So in early 1929 there was every sign that the boom was going to break down. I knew by then that the Americans could not prolong this sort of expansion indefinitely, and as soon as the Federal Reserve was no longer willing to feed it by more inflation, the thing would collapse.

In addition, you must remember that at the time the Federal Reserve was not only unwilling but was *unable* to continue the expansion because the gold standard set a limit to the possible expansion. Under the gold standard, therefore, an inflationary boom could not last very long.

MONEX: You've mentioned before that the depression of the 1930s was unnecessarily prolonged. Would you explain your reasoning for our readers, please?

HAYEK: In 1929, a crisis and depression of some length was inevitable. But it certainly need not have lasted for something like 10 years. It ought to have been over in two or three years, if sensible policies had been followed.

Instead of allowing the market to correct the misdirections of labor and resources that occurred during the inflationary boom, the government believed they could cure the depression by keeping up wages. Hoover began the policy, but Roosevelt greatly expanded it. The cry was—"For heavens sake keep up wages so that demand remains sufficient." Policies of government intervention in the economy led internationally to exchange controls, restrictions on foreign trade and other policies that only made matters worse.

The absence of a sound international monetary system was another factor that was responsible for the length of the depression. One of the single most important mistakes that unnecessarily prolonged the depression was Roosevelt's decision to go off the gold standard.

There was an international monetary conference in progress in London at the time that was on the whole working on a proposal along the right lines. The conference just blew up as a result of the American action. Roosevelt completely upset the whole international monetary system by that decision at just a time when there were some signs of a recovery.

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MONEX: Would you review some of the additional consequences that flowed from that decision?

HAYEK: Abandonment of the gold standard also set the stage for future inflation through a gradual elimination of restrictions on the free actions of politicians. Although the U.S. nominally continued on the gold standard, in fact the gold standard ended in 1933. The gold standard is by its nature international—no single country can have an effective gold standard because if just one country is on gold it means that the policy of that country determines the value of gold and not the other way around.

Then came Bretton Woods after World War II with its principle that no country should ever be required to contract its currency—all the adjusting would be done by expanding the money supply of the countries that had a favorable trade balance. That was the second stage. The third stage was abandoning fixed exchange rates and accepting flexible exchange rates and floating currencies. This means, of course, that a country is completely free in its monetary policy.

As long as the people who manage the national currency had to pay some attention to maintaining these rates there was some restraint on them. Now that they've gotten rid of that restraint, they are free to inflate all they want. The result is that we've had an inflationary boom that has lasted for some 35 years—an unprecedented situation.

MONEX: Do you think there's much hope of a return to the gold standard as a solution to the world monetary problems of today?

HAYEK: The chances of restoring any kind of gold standard has occupied me a great deal, and I don't believe that such an attempt can really succeed. As I've said, the gold standard is only effective as an international standard, and the chances of reestablishing it on an international basis are small.

The chances of its being maintained for any length of time at the present are almost nil because no country is as yet willing to submit to temporary periods of deflation and unemployment that the gold standard demands. I think before one can seriously wish that the gold standard be reestablished opinion has to change a great deal. Now it may be that a severe depression of some length will change public opinion to the point where people would agree that even with its defects the gold standard is preferable to what they are experiencing without it.

But before this can happen, countries must foreswear a monetary and fiscal full employment policy. They must realize they cannot permanently maintain full employment by inflation, or there is no chance of maintaining a gold standard. The gold standard, of course, puts a curb on politicians that forces them to do things they don't want to do. If you could get the politicians to submit to that discipline, it would be highly desirable. But I don't believe at the present time there's much chance of this happening.

"I think that if Lord Keynes had lived longer he would have become one of the main fighters against inflation."

MONEX: In *The Road to Serfdom*, you argue that John Maynard Keynes' theories, if carried far enough, will lead to the end of individual liberty and to totalitarian government. Keynes, nonetheless, gave the book an almost passionate endorsement, saying he was "not only in agreement with it, but in deeply moved agreement." Do you feel he may have changed his views in his later years?

HAYEK: No, I don't think he did. I knew Keynes well. In fact, personally we were good friends. We just generally avoided talking economics. We knew we couldn't agree on economics, but there were many other common interests. It didn't surprise me that he accepted the thesis of the book because he was basically of a libertarian outlook and concerned about any threat to liberty. It was not against Keynes that the *Road to Serfdom* was directed.

I do, however, feel that Maynard would have changed his views had he lived longer. What I blame Keynes for is to have called his major work a *General Theory*. It wasn't a general theory. It was admittedly adapted to the special needs of the 1930s when we had a general period of deflation. It was tempered for the moment and was never intended to be a general theory.

He was up to a point aware of this when I saw him in early 1946. I asked him whether he wasn't getting alarmed that some of his theories had led into inflation. He said—"Oh, Hayek, never mind. Don't be alarmed. These views were frightfully important in the 1930s. If they should ever become dangerous, just watch me. I'm going to turn public opinion around like this." And he made a movement of his hand, indicating a complete change of direction and emphasizing

The *Gold & Silver Newsletter* has usually presented interviews with persons who express a distrust of paper money under present economic circumstances, believe that governmental monetary policies must be radically changed, and believe that precious metals are an important element for the protection of a person's assets. However, economists and investment advisors hold widely varying views as to the economic outlook, continuance and degree of future inflation, possibility of recession or depression, price trends of precious metals, and the methods by which investors can protect themselves. Some economists and investment advisors agree and others disagree with the viewpoint presented in this issue. As is the case with many of our Newsletter interviewees, Dr. Hayek was paid an honorarium fee for his time.

Hayek (continued)

he had this great confidence that he was able to play on public opinion as an instrument. Six weeks later he was dead and couldn't do it.

I think if Lord Keynes had lived longer, he would have become one of the main fighters against inflation. I think it was a great calamity that he died when he did.

MONEX: What's your assessment of world economic conditions today?

HAYEK: My overall view of world economic conditions at this time is generally one of pessimism. I think there's a chance that people may become reasonable again and the depression that is now beginning will not last too long. It's possible. After all, with a working economy you can pull out of a depression extraordinarily rapidly. For example, after World War I —I believe it was 1921—American prices fell something like 40% within six months, causing acute depression. But there was a rapid adjustment, and within months recovery was underway because you still had a functioning price and market mechanism.

The German recovery after the hyperinflation of 1923, again, was possible because there existed a fully functioning labor market with the possibility of adjusting the relative wages very rapidly.

"You won't get away with a mild depression this time."

MONEX: Most economists refer to present economic conditions in this country as a recession. Do you see it as a depression?

HAYEK: Well, there's really no quantitative distinction between the two. The word recession was invented to avoid the scare word depression, and it just means a mild depression. But you won't get away with a mild depression this time. You may hope it will be a short one, but it will be a depression, and I don't think we've reached the depths yet. I don't want to set any figure, but unemployment is going to rise further.

MONEX: Do you think this depression is likely to be worse than the 1930s?

HAYEK: It's not impossible. On the other hand, as an economist, I feel it's my job to tell the people that it's not necessary if they follow reasonable policies. I don't think the chances are likely they'll do it. But it's possible.

MONEX: What's your assessment of recent actions taken by the Administration and Congress to deal with the nation's economic problems?

HAYEK: The Congress has done exactly as I expected and that's to try to cure the problem with another dose of inflation. It doesn't surprise me in the least. That President Ford should have temporarily resisted was more than I expected. I'm sorry that he didn't stick it out. But, again, I wasn't surprised that he finally signed the tax cut bill.

Now the resumption of an expansionist credit policy can still once more catch on for a time and temporarily revive the boom. And I fear that might happen. You see, if at the present moment they should succeed in prolonging the inflationary boom for another year or two, the ultimate collapse is going to be worse than it would be now. My general impression is that an inflationary expansion isn't very likely to catch on, but it may. I can't exclude that possibility. But personally, I would rather have a more moderate depression now than a worse one in two years time.

MONEX: In your 1931 book, *Prices and Production*, you wrote that the way out of a depression is through the slow process of the market correcting the mistakes made during the inflationary period. The public and the politicians, however, are rarely willing to do nothing about unemployment while this slow process runs its course. What is the solution?

HAYEK: You know you're asking me a question to which I have no answer and that's whether it's possible for a government to pursue a sensible policy as long as the public holds the wrong view of what can be done. I'd say it's almost a hopeless proposition for the government to pursue a sensible policy so long as the public is obsessed with the idea that there's a cheap way of curing unemployment. As an economist I can only argue this is a mistake.

But as long as people believe—and I think the great majority of people do believe—that the government has the power to eliminate unemployment quickly and lastingly, the government won't be able to stop the inflationary process. I think we have to teach people first that this is the price we must pay for the abuse of monetary policy for so many years. You must not expect that after having done the wrong thing for so many years, we'll get away cheaply after that.

MONEX: Haven't there been periodic recessionary adjustments over the years?

HAYEK: Yes, but they were very minor, very minor indeed. Those were periodic adjustments that did not involve a cessation of the inflation. It meant only a slowing down of the rate of inflation.

"I think the likelihood is that we will be moving into a completely controlled economy."

MONEX: What do you think is likely to happen if we continue to pursue the economic policies we have been following?

HAYEK: I'm fairly certain about two things. First, that attempts at so-called pump priming will probably sooner lead to acceleration of the price rise, rather than an increase in employment, and people will demand control of the price rise. The government will clamp on controls and pump more money into circulation, which will have the disappointing effect of not creating much employment.

Secondly, these developments will drive the country into a combination of price controls, public works of one sort or another and gradually into a completely government controlled economy. Yes, I think the likelihood is that we will be moving into a completely controlled economy with depression, and employment directly dependent on government spending on public works. Of course this is a situation from which it is very difficult to extricate yourself.

"Some may say gold is not money anymore, but it's a store of value which the paper money is not."

MONEX: Under the conditions that you see developing, what investment advice would you give to those who are concerned about protecting their assets?

HAYEK: For a long time I thought the major thing to do was to get out of bonds and into equities. But present day governments know how to destroy the chances of even a stable real income from equities.

I think that anyone who has a claim to a government pension is fairly certain not to have to starve—but no more than that. And anybody who relies on land is by no means certain that he may not starve in his old age. Apart from one's home, land is for most people not a real alternative investment, because governments are finding ways to make even land a bad investment. In England, they're moving toward making it a law that if you want to sell your property you must sell it to the government which will then resell it.

MONEX: What is your opinion of gold as an investment?

HAYEK: Well, people who did invest in gold were very wise indeed. Gold is not a certain investment—you could lose a substantial amount in gold, but probably less than in anything else. Compared to everything else, I would have to say that gold is an appropriate investment that I think will probably do better than most others.

MONEX: Why do you regard gold as perhaps a safer investment than most anything else?

HAYEK: Because as conditions continue to worsen, people will resort to the one thing which they regard as safe. I must admit that belief in gold is perhaps a superstitious one, but it's one that's not likely to be shaken. The more people despair of conditions, the more people will resort to the one familiar thing which you can cling to and ~~which you can put in~~ your pocket and walk away with.

Some may say gold is not money anymore, but it's a store of value which the paper money is not. If things come to the worst, you can bury gold in your garden. You won't make anything on it that way, but in 20 years time your children will still have something that has retained its value.

The government may again clamp down all kinds of controls on the possession of gold, but governments don't last forever. Even if the government puts the death penalty on the possession of gold, as the Nazis did, it won't prevent people from burying it in their garden to have something of value when the government has changed. To have something that will still be of value in 20 years time is, for the great majority of people, still very important.

MONEX: Thank you, Dr. Hayek. We'll be looking forward to your address at our Symposium on the economy later this month.