

## **Speech by Stephen Littlechild in honour of Friedrich Hayek**

**Austrian Embassy, 23 March 2022**

Thank you, Ambassador, for hosting this very congenial and well-deserved testimony to Friedrich Hayek, to commemorate the thirtieth anniversary of his death. And thank you to Madsen Pirie and the Adam Smith Institute for inviting me to speak.

I am not an expert on Hayek. But I have admired his work for over 60 years now, and have used his distinctive concept of competition many times. I appreciate this opportunity to explain and pay tribute to him.

Perhaps unusually, and probably rather fortunately, I learned about Hayek before I learned about economics.

I was in the sixth form of a small-town grammar school, and I decided that I would like to be a millionaire. But A level Economics was not on the menu, and it seemed that understanding how the City of London worked would be a useful first step. So I subscribed to the *City Press*, which was delivered each week to my local WHSmith.

In the pages of the *City Press* I discovered that there was a chap called Keynes, who generally got things wrong, and two chaps called Mises and Hayek who got them right. For example, Mises and Hayek and the *City Press* explained why free trade was better than protectionism, and I was led to join the Keep Britain Out campaign. We lost that campaign, of course, but when Brexit came I'm afraid my vote was predetermined.

Anyway, in 1961 I went on to study Commerce at the University of Birmingham. I was amazed to discover that the chap who generally got things wrong had a whole Economics course devoted to him. Whereas the chaps who got things right were never mentioned at all. But I was not deterred, and I see that in 1962 I bought and read the *Road to Serfdom*, which was not on any of the reading lists.

After I graduated in 1964 I was invited to stay on and lecture at the University of Birmingham. I prepared for this by spending about a month in the summer studying in detail four substantial books, an hour on each book every morning. The 10 – 11am book was Mises *Human Action*, which I discovered had only been taken out of the library once before, back in 1950 I think. The logic was compelling, but he seemed rather a dogmatic chap, and the book was quite hard work.

The 11-12am book was Hayek's *Constitution of Liberty*. Although the *Road to Serfdom* was perhaps more popular, and some of his later works arguably more topical or erudite, for me the *Constitution of Liberty* reflects more fully what I sense of Hayek the man. He was a widely read and serious intellectual but also a passionate, compassionate and very humane man. He had a deep belief in freedom and was trying to explain the importance of it, analysing how it relates to the law, and also exploring the practical implications for various central aspects of economic policy. In simple terms, as he himself put it in the Preface, "My aim is to picture an

ideal, to show how it can be achieved, and to explain what its realization would mean in practice.”

My assigned responsibility was the third year Government and Industry course. Much of what I taught was based on my lecture notes from the previous year. However, I could begin to see the possibility of an alternative approach to analysing Government policy – not just descriptive and institutional, not just applying neo-classical welfare economics, but also exploring an Austrian perspective. About a decade later, I formalised this in my monograph *The Fallacy of the Mixed Economy*, subtitled *An ‘Austrian’ critique of economic thinking and policy*. Although many Austrian and associated writers were cited, it seems to me that Hayek’s mixture of economic theory and practical application is what pervades the monograph.

Perhaps the same could have been said of my approach to privatisation, competition and the regulation of the electricity industry. I don’t recall mentioning Hayek specifically while I was regulator, but you may have seen Professor Sir Dieter Helm’s frequent reference to “the Austrians”, which I take it now referred to the writings of Michael Beesley and myself.

At one point, as a young scholar of Austrian economics, I was allotted a short one-on-one session with Hayek. I seized on the only gap in his work that I could find. “How is it that you never wrote about economic externalities?” I asked. He replied gently, “In the 1930s there were more pressing problems to analyse, like the mass unemployment of people and resources.” I was suitably humbled. And of course, that part of his work with which I was particularly familiar was just a fraction of his lifetime’s work, which also covered monetary theory and the trade cycle, inflation, the philosophy of science, and of course law, legislation and liberty, as well as much else.

Hayek’s work on competition as a rivalrous process taking place over time reflects a more general Austrian theme, of course, and others including Schumpeter and Kirzner have made distinctive contributions to it. But Hayek’s approach seems to me to have added a new vitality and practicability to the economic and policy analysis of competitive markets, which is no less relevant today than in Hayek’s own time.

For example, just last year, Lynne Kiesling and I analysed the widespread Texas electricity blackouts in February 2021, by asking “what would Hayek have advised?”<sup>1</sup>

- We were confident that Hayek would have supported the introduction of wholesale and retail competition into the electricity sector, where Texas has gone further than any other US state.
- Hayek would also have accepted certain coordinating and regulatory bodies (ERCOT and the Public Utility Commission of Texas or PUCT) which some free-market commentators have resisted or rejected.
- But the Texas Commission considered, along with all other electricity regulators, that an unfettered competitive market was likely to lead to persistent excessive pricing,

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<sup>1</sup> Stephen Littlechild and Lynne Kiesling, “Hayek and the Texas blackout”, *The Electricity Journal*, 34(6), July 2021, Working Paper available at [https://www.eprg.group.cam.ac.uk/wp-content/uploads/2021/06/2118-Text\\_1.pdf](https://www.eprg.group.cam.ac.uk/wp-content/uploads/2021/06/2118-Text_1.pdf)

which would be punished by the regulators, and hence generators would be deterred from investing in enough capacity. We did not think Hayek would have been convinced of this argument.

- The Texas Commission, in contrast to all the other US states and almost all the rest of Europe, decided that it was unnecessary and undesirable for the regulatory body to introduce a “capacity mechanism” to ensure sufficient capacity in the market. Hayek would have agreed with that position.
- However, the Texas Commission introduced something different: an Operating Reserve Demand Curve (ORDC) which increased the size of the “reliability adder” during times of greater capacity shortage, in order to send a stronger price signal to potential investors. Hayek might have seen the theoretical case for this concept, because he believed in price signals, but were the right price signals being sent?
- The Texas Commission set prices at a maximum level of \$9,000/MWh, or \$9 per kWh, during the critical shortage period. This was in a year when the average price of electricity was around 12 cents/kWh. That is, the maximum regulated price was 75 times the level of average price. As one retailer commented “Obviously, in any other industry, this would be considered price gouging during an emergency.” Hayek would surely not have wanted to countenance the imposition of such pricing.
- In the event, the price was kept at that maximum penal level for several days longer than it should have been, according to the rules. Reportedly, this was at the request of the Governor of Texas via the Chair of the Texas Commission. Hayek would probably not have been surprised, but interestingly the possibility of regulatory error and/or political pressure was not a factor he typically emphasised.
- Hayek wanted price signals to be generated by freely negotiating market participants, not set by regulatory decree.
- Lynne and I think that Hayek’s thinking would better be reflected by trying to replace a market-wide formula for setting a uniform price, by a more decentralised process of price-setting, with different prices set by different parties in different parts of the network, thereby better reflecting local supply and demand conditions, and involving local communities.

But enough of our ideas. We are here to celebrate Friedrich Hayek himself. I have tried to indicate how and why his thinking was important for me, and for the proper understanding of competitive markets. So let me conclude with one more short personal anecdote.

I happened to sit nearly opposite Hayek at a dinner during a conference. The conversation flowed over many topics, and at one point Hayek saw an opportunity to contribute. “Burgundy!” he exclaimed. “Now that’s something that I do know something about.” I leaned forward eagerly, since I too was interested in wine. But the conversation had moved on, and I fear we may never know what Hayek knew about Burgundy.