A TALE OF TWO SCHOOLS (KEYNES AND THE CLASSICS)

Roger W. Garrison, Auburn University

Classicism–in its Austrian variation

In 1969 British economist and Nobelist John R. Hicks wrote:

When the definitive history of the economic analysis during the nineteen-thirties comes to be written, a leading character in the drama (it was quite a drama) will be Professor Hayek. Hayek's economic writings–I am not concerned with his later work in political theory and in sociology–are almost unknown to the modern student; it is hardly remembered that there was a time when the new theories of Hayek were the principal rival of the new theories of Keynes. Which was right, Keynes or Hayek?

Keynesianism–as broadly interpreted in its heyday

In 1998 American economist and Future Nobelist Paul Krugman wrote:

[I]f one asks what substantive contributions [F. A. Hayek] made to our understanding of how the world works, one is left at something of a loss. Were it not for his politics, he would be virtually forgotten.

CAPITAL-BASED MACROECONOMICS (Friedrich A. Hayek)	**LABOR-BASED MACROECONOMICS (John MaynardKeynes)**
means-ends framework	income-expenditure framework
structure of production	structural fixity
Hayekian **triangle**	**circular** flow
stage-specific labor markets	THE labor market
flexible relative prices and relative wage rates	fixed (or sticky) prices and wage rate
possible movements along the PPF	PPF as boundary between unemployment and inflation
interest as a real phenomenon (S & D of loanable funds)	interest (largely) a monetary phenomenon

Classical (Austrian) theory explains why ill-conceived or politically motivated macroeconomic policies do not actually have the beneficial effects suggested by the political rhetoric used to justify them. In particular, it shows how monetary policy aimed at "growing the economy" can create an artificial boom–and a subsequent bust.

Classical (Austrian) theory suggests that market economies are stable and blames recessions, inflations, and business cycles on ill-conceived fiscal and monetary policy.

Policy prescription: *Laissez-faire*

Keynesian theory serves as a basis for prescribing fiscal and monetary policies for achieving full employment, reducing inflation, and for "growing the economy"–that is, for making the economy's growth rate exceed the rate implied by the savings that income earners have made available to the business community.

Keynesian theory blames recessions, inflations, and business cycles on the market economy and specifically on the inherent instability of the investment sector.

Policy prescription: Fiscal and monetary stimulants and stabilizers