Comparing the modern view on keynsian and austrian economics

Home Blog Austrian economics vs Keynesianism and Kaletsky Austrian economics vs Keynesianism and KaletskyAnthony J. Evans 6 May 2009 Recently in The Times Anatole Kaletsky attacked the ??? many financiers [that] have been calling??¦ for a ??? market solution??™ based on the so-called Austrian school of economic analysis.??? I am surprised that a prominent commentator deems it necessary to write such a piece. Very few politicians, commentators, or indeed ??? financiers??? are familiar with Austrian economics, and those that are dismiss it as outdated without even understanding it. Kaletsky does little to address this ignorance, writing ??? one does not have to go into economic details??¦ to see why it makes no sense???. Sadly his argument is not only misrepresentative, but also downright disingenuous. For example, he repeats the customary false-attribution when he suggests that Andrew Mellon utilised Austrian theory when urging Herbert Hoover to liquidate during the Great Depression. In a recent article for the Journal of Money, Credit and Banking Larry White refutes this myth ??“ it was the real bills doctrine that governed their thinking, and Mellon in fact called for monetary and fiscal expansion.

Kaletsky goes on to provide two reasons why Austrian ??? austerity??? does not work. First, he argues that cutting spending and raising taxes would compound the effects of a recession and destroy public finances. Aside from the absurd notion that Austrians advocate tax rises, his logic is flawed.

He is right that ??? the only way to reduce deficits it to restore economic growth??? but this is a technical argument about what constitutes economic growth. Paul Krugman argues that World War II provided the boost in government spending necessary to restore GDP. An Austrian would reply that a military draft is not full employment, and war spending is not economic prosperity. The fact that government spending raises GDP is an accounting identity, not economic theory.

Our goal should be prosperity, not inflated GDP figures. His second criticism of the Austrian school is that the general public would not support it. But the popularity or feasibility of a policy does not determine the scientific merit. It is quite possible to introduce measures that are unpopular but increase long-term prosperity ??“ especially when the public are fed such slanted views on what those policies are. Yes, readers may prefer immediate job preservation than future job creation. It is the role of the economist to point out the hidden costs associated with such short-termism.

Kaletsky believes that ??? we may be witnessing the clearest empirical demonstration that Keynesian demand management really can stabilise the market economy???, but how would we know Even the Chair of Barack Obama??™s Council of Economic Advisors (Christy Romer) accepts that fiscal stimulus played little role in the end of the Great Depression, and there is scant evidence of it ever working. According to Kaletsky if the current stimuli fail to revive growth the G20 will simply print even more money. Presumably if that fails he would conclude that it wasn??™t enough. This is what happened with Japan during the 90s; Keynesians like Paul Krugman argued for fiscal expansion, and when it came ??“ and didn??™t work ??“ argued for even more.

The Keynesians created an unfalsifiable position: if the economy rebounds (regardless of the cause) it proves that a fiscal stimulus works. If the economy doesn??™t rebound, it proves that the fiscal stimulus wasn??™t large enough. They are incapable of even acknowledging the alternative view ??“ that permanent budget deficits are what prompt governments to monetise their debt (creating the boom-bust cycle) and that arbitrary interventions and bailouts during the crisis create the regime uncertainty that prolongs it. I am encouraged to see Austrian theory mentioned to such a wide readership, but only hope readers have more confidence in common sense economics. It is obvious that you cannot escape debt by borrowing more money, nor can you generate economic prosperity without letting failing businesses relinquish their assets to more successful ones. This was true during the Great Depression, is true today, and will be true tomorrow