

Keynesian vs. Classical

The Battles of Ideas

Keynesians

- Business cycles are a result of INTERNAL factors...beware of those "animal spirits"
- Economic instability will be/can be long in duration
- The main determinant of output and employment is AD...all about the consumer, income and spending!!

Keynesians

- Savings (leakages) DO NOT equal Investments (injections)
- More saving means less consuming which means less output and employment
- Interest rates DO NOT equate leakages with injections! "You can lead a horse to water..."
- Wages and Prices ARE STICKY and DO NOT self adjust downward

Keynesians

- Capitalist economies CAN NOT self adjust due to sticky wages, sticky prices and lack of interest rates attracting investment spending.
- Proper role of government? ...Get us out of this mess!
- SRAS is horizontal

Classical

- Business cycles are a result of EXTERNAL factors...beware of wars, natural disasters and geo-political instability
- Economic instability is temporary in nature..."we can work it out"
- The main determinant of output and employment is AS...Say's Law: "If you supply it, they will buy it."

Classical

- Savings (leakages) DO equal Investments (injections)
- More saving means more money in banks which means lower interest rates which means more borrowing and investment.
- Interest rates DO equate leakages with injections!
- Wages and Prices will self adjust downward

Classical

- Capitalist economies CAN self adjust due to flexible wages, prices and interest rates.
- Proper role of government? ...Stay out of the way and let it self-adjust.
- SRAS is vertical