TWO ANNIVERSARIES

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The year 2012 marks the anniversary of two publications that 75 years after their appearance still characterize a fundamental rift in economic theory and policy. John Hicks' "Mr. Keynes and the "Classics"", *Economic Journal* 1937, was one of several attempts to understand the differences between John Maynard Keynes' *General Theory of Employment, Interest and Money*, that had been published the year before, and what then counted as mainstream economics. Friedrich August von Hayek was one of the main representative of this, and he had certainly been Keynes' main opponent in the years between 1931 and 1936. Hicks was not the only economist who made such an attempt - B. Reddaway, "The General Theory of Employment, Interest and Money", *The Economic Record* 1936, R.F. Harrod, "Mr. Keynes and Traditional Theory", *Econometrica* 1937 and O. Lange, "The Rate of Interest and the Optimum Propensity to Consume", Economica, 1938 are others. But what distinguishes Hicks' article from the others is that it became the basis of the IS-LM model, which for some six decades has been the core of macroeconomics. This model introduced, for the first time in the history of economic thought, a distinction that continues to dominate, to this very day, all debates on macroecomic policy, that between fiscal policy and monetary policy. This was an unintended and unexpected result of Hicks' article; its author was mainly interested in understanding which of the two theories was more general: Keynes' or Hayek's.

Keynes and Hayek agreed that monetary causes play an important part in the analysis of business cycles. There are, however, two important issues that separate them, one methodological, the other economic. The economic difference has to do with the relationship between short-run and long-run analysis. Keynes' analysis, both of the *Treatise on Money* of 1930 and the *General Theory*, is explicitly of the short run. It abstracts from changes in the production structure of the economy: the stock of capital is assumed to be constant. The crux of Hayek's theory, on the contrary, is that the business cycle consists of a particular type of changes in investment behaviour and hence changes in the capital structure of the economy. He concedes to Keynes that if these changes are abstracted from, then Keynes' analysis is correct. Increases in the money supply may reduce unemployment as long as the limits of the production capacity are not reached. So, according to Hayek, his own theory is more general, and Keynes' is a special case.

Keynes attached much importance to the generality of his own theory, and he says the relationship is just the reverse. In the Preface of the *General Theory* he states that his is a "more general theory, which includes the classical theory as a special case" (*GT*: vii). In Keynes' jargon, "classical" refers to a group of theories that includes Hayek's. And the first chapter starts with:

> "I have called this book the *General Theory of Employment, Interest and Money*, placing the emphasis on the prefix *general*. The object of such a title is to contrast the character of my arguments and conclusions with those of the *classical* [and in a note he explains that he means by this "followers of Ricardo" such as Marshall, Edgeworth and Pigou; we may add Hayek to this list] theory of the subject ... I shall argue that the postulates of the classical theory are applicable to a special case only and not to the general case, the situation which it assumes being a limiting point of the possible positions of equilibrium." (*GT*: 3)

Keynes' use of the word "general", however, is not unequivocal. In the Preface to the French edition of the General Theory he writes about the word "general": "I mean by this that I am concerned with the behaviour of the economic system as a whole." In his reply to Hayek's review of the *Treatise*, Keynes had admitted that his theory lacked a theory of capital (the development of which Joan Robinson put on her research agenda right in 1936; it culminated in *The Accumulation of Capital in 1956*). What he never admitted, though, was that Hayek's theory of the business cycle, which relied on capital theory, was more general than his own for that reason.

So there was quite some confusion about the claim to generality of Keynes' theory and it is understandable that Hicks wanted to throw light on it.

The other publication whose 75th anniversary I want to draw your attention to is Hayek's *Monetary Nationalism*. This is a booklet that contains five lectures he gave at the Graduate Institute of International Studies in Geneva. The topic is the international monetary system, and more in particular "monetary nationalism", by which Hayek means the idea "that it would be possible, while remaining a member of the international commercial community, to prevent disturbances from the outside world from reaching the country by following a national monetary policy such as would be indicated if the country were a closed community. [This idea] has proved … and [, unless it is abandoned,] will prove … to be one of the main forces destroying what remnants of an international economic system we still have." (p. 71). In the light of the current global economic crisis that has now entered its fifth year, this sounds very contemporary - as contemporary as the ongoing discussion on whether this crisis has fiscal or by monetary causes and whether the remedies should be fiscal or monetary. So, even though the crisis gives us little cause for celebration, I would like to remind the reader of this twin three-quarters-of-a-century anniversary.

What also gives little cause for celebration is the fact that after 75 years economists have not been capable of making significant progress. Each and every time a crisis occurs, the debate whether the causes and remedies are of a long-run or a short-run character, lie in the real or in the monetary sector, require more regulation or more freedom for markets, whether the interest rate ought to be kept low by policy measures or be left to market forces starts almost from scratch. What perhaps is most worrying of all is the fact that after the Bretton Woods accords, which are in large part inspired by Keynes' ideas yet incorporate some of Hayek's 1937 suggestions, we are still without a satisfactory global monetary and financial system. For who knows the history of economic thought of the last century, the current debates on the crisis have a taste sense of déjà-vu. In a very real sense, the controversy between Keynes and Hayek is as alive as ever.