MPRA
Munich Personal RePEc Archive

Been there done that: the political economy of Déjà Vu

Boettke, Peter and Smith, Daniel and Snow, Nicholas

2011

Online at https://mpra.ub.uni-muenchen.de/32094/
MPRA Paper No. 32094, posted 07 Jul 2011 19:31 UTC

DEPARTMENT OF ECONOMICS

Been There Done That:
The Political Economy of Déjà Vu

Peter J. Boettke,
Daniel J. Smith
and
Nicholas A. Snow

George Mason University
Department of Economics
Paper No. 11-13

Electronic copy available at: http://ssrn.com/abstract=1764273

Been There Done That:
The Political Economy of Déjà Vu

Peter J. Boettke, Daniel J. Smith and Nicholas A. Snow

"In spite of the incredible reputation of the General Theory, I could not find in it a single important doctrine that was both true and original. What is original in the book is not true, and what is true is not original. In fact, even most of the major errors in the book are not original, but can be found in a score of previous writers."
-Henry Hazlitt (1995 [1960], 3)

"We have been going back and forth for a century. I want to steer markets (Keynes). I want them set free (Hayek)."
-John Papola & Russell Roberts (2010)

1 Introduction

In the midst of the current financial crisis the economics profession has seen a monumental resurrection of Keynesian ideas. The debate, which Keynes started back in the 1930s, is being picked up again, not where it left off, but in exactly the same place it started. While Keynesian theories were carefully critiqued by new classical economists and in the most part discarded by the profession, Keynesian models and prescriptions became a staple of politics and macroeconomic textbooks. Obviously, neither side of the debate articulated their views adequately and on the same terms. If the economics profession is going to escape this perpetual déjà vu of cycling through the same debate every time an economic crisis emerges, the profession must discard entrenched ideologies and turn back to the sound but creative application of basic economics.

On October 17, 1932 D.H. Macgregor, A.C. Pigou, J.M. Keynes, Walter Layton, Arthur Salter, and J.C. Stamp (Macgregor et al. 1932) posted a letter in the *Times of*

Electronic copy available at: http://ssrn.com/abstract=1720263

London articulating what they believed was one of the primary causes for the continuation and severity of the Great Depression, private spending. They were deeply concerned by the fall in consumption at that time, and believed government action was necessary to counteract this fall in aggregate demand, "[t]he public interest in present conditions does not point towards private economy; to spend less money than we should like to do is not patriotic" (Macgregor et al.1932, 13). They continued further,

> *Moreover, what is true of individuals acting singly is equally true of groups of individuals acting through local authorities. If the citizens of a town wish to build a swimming-bath, or a library, or a museum, they will not, by refraining from doing this, promote a wider national interest. They will be "martyrs by mistake" and, in their martyrdom, will be injuring others as well as themselves. Through their misdirected good will the mounting wave of unemployment will be lifted still higher.*

While they thought most of their fellow economists would agree with them, they did anticipate some dissent. T.E. Gregory, F.A. von Hayek, Arnold Plant, and Lionel Robbins (Gregory et al. 1932) responded in the *Times of London* on October 19, 1932. Gregory et al. took issue with Macgregor et al.'s lack of understanding of the difference between consumption and real investment. Instead, they argued that investment was crucial to lengthening the process of production. While increased consumption would fuel immediate consumption industries, it would not provide the incentive for productive long-term investments. Gregory et al. disagreed with Macgregor et al.'s insistence that government had both the capacity and the incentive to use deficit spending to increase aggregate demand. Gregory et al. (1932, 10) believed that "[i]f the Government wish to help revival, the right way for them to proceed is, not expenditure, but to abolish those restrictions on trade and the free movement of capital (including restrictions on new issues) which are at present impeding even the beginning of recovery."

Electronic copy available at: http://ssrn.com/abstract=1724263

The exchange on the pages of the *Times of London* Between Keynes (Macgregor 1932) and Hayek (Gregory 1932) was just the start of what was to become one of the most important public policy debates of the century; one that would continue until even the present day.[1] While Keynes's ideas had a deep influence on the economics profession, it arguably even had a bigger impact on public policy, where once adopted, never waned despite scholarly rejection. Keynes's deficit spending prescriptions effectively eliminated the budget constraint of public officials, engendering a dramatic jump in the growth of government deficit spending and the size of government in general (Buchanan and Wagner, 2000[1977]; Buchanan, Burton and Wagner, 1978; Hayek 1976, 90). As Cochrane (2009) explains "[f]iscal stimulus can be great politics, at least in the short run. The beneficiaries of government largesse know who wrote them a check. The businesses and consumers who end up getting less credit, and the businesses that can't sell them products, can only blame 'the crisis,' and call up their congressmen to get their own stimulus."

It is important to note, as Skidelsky (2009, 103) points out, that many of Keynes's followers bastardized his theory in order to justify policies that even Keynes did not approved of (also see Leeson 1997 & 1999). Towards the end of his life, even Keynes

[1] While Hayek published *Prices and Production* in 1931, and Keynes published *Treatise on Money* in 1930 (some of the 'Keynesian' ideas can even be traced back further to 1926 in his *The Economic Consequences of the Peace*), both books that established their separate systems, they were not in contact during the publication of these books (Hicks 1967). In 1936 John Maynard Keynes published *The General Theory of Employment, Interest and Money (General Theory)*, a book that laid out the groundwork for the wide scale acceptance of his ideas , jump-starting the 'Keynesian Revolution,' a revolution in macroeconomic thought that rejected the classical view that markets are inherently self-correcting, instead holding that markets are in a constant state of employment disequilibrium and that government intervention is necessary to allow free markets to work (Keynes 1934). Established economists at the time simply rejected any such notion of a revolution. As Frank Knight (1937) mentioned in his review, "I may as well state at the outset that the direct contention of the work seems to me quite unsubstantiated." Even Keynes's intellectual opponent, F.A. Hayek chose not to review the book, believing that it was just "…another tract for the time," and meant primarily for the "...momentary needs of policy" (Hayek 1966[1995], 241). The older economists mostly rejected Keynes's ideas but the young took it and ran with it, making sure the debate continued throughout the century.

questioned the desirability of having government take more than 25% of national income (Skidelsky 2009, xvi). Skidelsky (2009, 103) does admit though, that Keynes was partially at fault for this because, Keynes, in his hurry to get policies enacted, did not insist on close adherence to his theories (also see Leijonhufvud 1968).

A few economists saw through the alluring Keynesian promises of growth inducing profligacy and levied a decisive critique of Keynesian economics and its followers, which became known as the 'New Economics.' Henry Hazlitt was one of the most thorough critics of Keynes, publishing both an almost line-by-line refutation of Keynes's *General Theory* (1959) and an edited volume of the critics of Keynesianism ([1960], 1995). Despite the severe shortcomings found in the Keynesian model by its critics, revealing the fallacy of the Keynesian system, Keynesian ideas have witnessed a surge in popularity in the wake of the current financial crisis, especially in the political arena. Looking over the debates that occurred in the past and comparing them to those occurring today, one cannot help but get a feeling of déjà vu that we are, once again, embarking down the economically dangerous road of deficits, debt and debasement (see Smith 1776; Beaulier and Boettke 2009).

Nearly eight decades after the onset of these Keynesian ideas, the debate over the efficacy of public spending during economic downturns is once again in full swing. In the *Sunday Times* a debate broke out between economists led by Tim Besley and Lord Robert Skidelsky respectively. Besley et al.'s letter on February 14, 2010 warns the UK against the problems that plague governmental fiscal policies. Along with 19 other co-signers, he states "[i]n order to restore trust in the fiscal framework, the government should also introduce more independence into the generation of fiscal forecasts and the scrutiny of the government's performance against its stated fiscal goals." Robert Skidelsky, along with 56 co-signers (among them Brad DeLong and Nobel Laureate Joseph Stigliz), fired back on February 18, 2010,

> *They seek to frighten us with the present level of the deficit but mention neither the automatic reduction that will be achieved as and when growth is resumed nor the effects of growth on investor confidence. How do the letter's signatories imagine foreign creditors will react if implementing fierce spending cuts tips the economy back into recession? To ask – as they do – for independent appraisal of fiscal policy forecasts is sensible. But for the good of the British people – and for fiscal sustainability – the first priority must be to restore robust economic growth. The wealth of the nation lies in what its citizens can produce.*

Another example of the return of this debate came when economists Brad De Long and Luigi Zingales (Lane, Long & Zingales 2009) in a recent issue of *The Economist* debated the desirability of Keynesianism. De Long asserts that the issue comes down to Say's law, which he claims, "[a]nyone who uses his or her eyes can determine that Say's law is in general false." Much of the Keynesian refutation of Say's law is suspect, as Hazlitt (1995 [1960], 6) pointed out, "Keynes 'refuted' Say's Law only in a sense in which no serious economist ever maintained it." In reality, the Keynesians, even today, are adhering to the same distorted interpretation of Say's Law (see Horwitz 1997; Kates 1998).

Zingales was more on the mark. He claims the only way "we are all Keynesians now" is in the sense that politicians and the general public are drawn into the Keynesian mentality. As he said,

> *Keynesianism has conquered the hearts and minds of politicians and ordinary people alike because it provides a theoretical justification for irresponsible behaviour. Medical science has established that one or two glasses of wine per day are good for your long-term health, but no doctor would recommend a recovering alcoholic to follow this prescription. Unfortunately, Keynesian economists do exactly this. They tell politicians,*

> *who are addicted to spending our money, that government expenditures are good. And they tell consumers, who are affected by severe spending problems, that consuming is good, while saving is bad. In medicine, such behaviour would get you expelled from the medical profession; in economics, it gives you a job in Washington.*

Despite the fact that these Keynesian ideas have once again gained prominence among even some notable economists, we would be reckless to discard the lessons from the past and re-embrace these ideas. Arguments made and the lessons learned have not been retained, and once again we are heading down the path of fiscal profligacy, and capricious government intervention. These misguided policy recommendations, which are all too quickly embraced by politicians eager to curry favor with special interest groups come at precisely the time when basic economics shows the need for fiscal austerity and political stability.

The remainder of this chapter will explain the evolution of the Keynesian ideas and show that some modern economists have adopted back the Keynesian tenants, almost wholesale, when the current financial crisis hit. We will examine the modern arguments advanced by Keynesians such as Paul Krugman and Brad DeLong, and demonstrate that they are essentially making the same arguments that were advanced in the past. We show that the critiques levied by Keynesian critics back in the 1950s are just as relevant and devastating to Keynesian propositions today as they were in the past but need to be more creatively presented in order to catch hold.

2 Keynesian History

John Maynard Keynes published his *General Theory* after the worst period of the Great Depression had ended and recovery had commenced. In the *General Theory*, Keynes holds that the economy is primarily in a state of unemployment equilibrium, rejecting the classical model of full equilibrium. Many of these ideas directly called into question the common beliefs in economics, not just at the time but even today. As Frank Knight (1937) noted, "…Mr. Keynes's own doctrines are, as he would proudly admit, among the notorious fallacies to combat which has been considered a main function of the teaching of economics."

The economy is mired in a chronic state of recession because of excess savings and thus, a lack of consumption and investment. According to Keynes, investment falls short of savings because of the decreasing Marginal Efficiency of Capital as more investment is made in the same homogenous capital, as well as the capriciousness of the determinates of the interest rates (Shackle 1973; Skidelsky 2010, 92) . The lack of consumption and investment in turn leads to unemployment and a slowdown in production, decreasing income and consumption even further. The only way out of this "paradox of thrift" is for government to run budget deficits during times of economic recession to increase consumption and investment. Even if the public money is not channeled into productive investments it would still do its job in jumpstarting consumption and production by creating jobs. Keynes argued that budget deficits could be afforded because they would later be made up by budget surpluses in better economic times.

In the wake of the *General Theory* came many attempts at interpreting Keynes's ideas, engendering an extensive body of newly inspired macroeconomic work. As Paul Samuelson (1988) observed, "[t]he Keynesian revolution was the most significant event in 20^{th}-century economic science." In the first few decades after the General Theory was published, the followers of Keynes sought not only to clarify what Keynes had said but also to understand and account for the counter-arguments being made at that time.

Essentially the early Keynesians believed the economy was inherently unstable and subject to shocks due to their belief that investment was erratically influenced by 'animal spirits,' and thus subject to huge swings based upon artificial considerations. Once out of equilibrium, they believed, the economy would take a long time to recover on its own, if at all, as Keynes held that there was no inherent tendency back to full employment equilibrium in the free market. Thus, they argued that government intervention was required to restore effective aggregate demand in order to bring the economy back to full employment, and they believed that this was best achieved through fiscal, rather than monetary policy. As Keynes (1932, 60) wrote, "…there will be no means of escape from prolonged and perhaps interminable depression except by state intervention to promote and subsidise new investment."

By the 1950s many believed that Keynes and his followers had won the day. Samuelson (1955) showed that 90 percent of American economists accepted the 'neo-classical synthesis,' meaning they generally accepted the classical model for microeconomic issues and the Keynesian model for macroeconomic issues. In the neo-classical synthesis, macroeconomics takes precedence over microeconomics, especially during economic downturns because unless the economy is in macroeconomic balance, microeconomic market forces won't operate. While this last point is similar to the new classical perspective, it is important to note a point that Boettke (2009b) makes that distinguishes the two approaches,

> *…while there may be macroeconomic problems, there are only microeconomic explanations and solutions. Aggregate variables do not*

> *interact with one another independent of the choices of individuals. And those choices are guided by the incentives actors face, and the informational signals they receive. In short, economics is about exchange and the institutions within which exchanges take place. It is all about property rights, relative prices, the lure of profit and the penalty of loss.*

In the long run the classical model was correct but economists seemed to believe the Keynesian model was necessary for short run aggregate phenomena. In other words, though it was generally held that fiscal austerity and balanced budgets were economically desirable, these fundamentals should be abandoned in times of economic hardship. As Hayek (1966[1995], 241) wrote, *The General Theory*, "…more than any other single work," furthered the "…ascendancy of macroeconomics and the temporary decline of microeconomic theory."

Despite this dominance in macroeconomics from the 1950s to the 1970s there were a few lone voices making important criticisms of the Keynesian theory. On December 31, 1965 *Time* magazine quoted Milton Friedman as declaring "[w]e are all Keynesians now," but Friedman corrected the quote by providing the context in a letter to the editor on February 4, 1966 writing,

> *You quote me [Dec. 31] as saying: "We are all Keynesians now." The quotation is correct, but taken out of context. As best I can recall it, the context was: "In one sense, we are all Keynesians now; in another, nobody is any longer a Keynesian." The second half is at least as important as the first.*

Friedman was referring to the fact that even though Keynesian ideas were on the way out in the profession because they could not be grounded in microeconomic foundations, in times of economic turmoil, economists and politicians would still turn in desperation back to the empty, but alluring Keynesian promises. By the 1970s, Keynesian ideas were thought to have been relegated to the history of economics within the profession, though it was never eradicated from politics or textbooks. Friedman's monetarist counter-revolution helped illustrate many of the flaws with the Keynesian models and helped pave the way for a revival of the classical approach which became known as the 'New Classical' school, led by Robert Lucas. Lucas & Sargent (1978) rejected the Keynesian model as well as attempts to modify it,

> *…existing Keynesian macroeconomic models cannot provide reliable guidance in the formulation of monetary, fiscal, or other types of policy. This conclusion is based in part on the spectacular recent failures of these models and in part on their lack of a sound theoretical or econometric basis. Second, on the latter found, there is no hope that minor or even major modification of these models will lead to significant improvement in their reliability.*

The massive inflation, and even stagflation, of the 1970s coupled with the theoretical contributions of the Monetarists and New Classical Economics led to a shift in macroeconomic thinking (Buchanan 2001[1986], 324). A renaissance of the market economy shifted the macroeconomic view of the role of government. They held that government intervention inhibited the self-correcting tendencies of the market. What was needed, especially in times of economic recession, was not more government intervention, but less government intervention. Keynesian theorists were forced back to their drawing boards because they had no way to incorporate these microeconomic foundations into their aggregated macroeconomic models while retaining the traditional Keynesian governmental panaceas they favored.

The New Keynesian theorists ended up adopting some key features of the New Classical School. Namely, they attempted to titivate the Keynesian models by incorporating microeconomic foundations. The New Keynesian literature has attempted to "search for rigorous and convincing models of wage and/or price stickiness based on maximizing behaviour and rational expectations" (Gordon 1990). So while Keynes described the economy as inherently out of equilibrium, with no tendency towards it, New Keynesians view the market as always tending towards equilibrium, just that certain rigidities prevent the market from equilibrating automatically, leaving some room for government intervention, but, as Cochrane (2009) explains "…not to rescuing the ancient view that fiscal stimulus is important…"

3 The Current Crisis and the Return of Basic Keynesian Ideas

There are still modern adherents of Keynesianism who attempt to defend the traditional Keynesian prescriptions despite the many theoretical shortcomings of the outmoded model. Additional layers of sophistication and technicality have been added, but they are still built upon the same debunked Keynesian foundations. As John Cochrane (2009) points out about the theories used to debunk Keynesiansim, "[t]his is not fancy economics. Most of my arguments come from simply asking where the money is going to come from, simple arithmetic." To their credit, some modern adherents of Keynesianism such as the above mentioned New Keynesians, have outright rejected Keynesian tenets and prescriptions that have failed to find support in basic microeconomic theory.

Modern Keynesians have also attempted to justify stimulus policies based upon modern government capabilities. Just as Mises (1952, 69) said of Keynes and his *General Theory,* "[w]hat he really did was to write an apology for the prevailing policies of governments," so too are ideas of modern Keynesians. These theories hold that with advances in oversight and accountability practices, political pitfalls that have plagued past stimulus attempts, such as stimulus funds being directed to politically motivated projects rather than towards productive investments, can be avoided. The internet, better accountability standards and refined management techniques, they argue, can ensure that stimulus funds are funneled only to those projects that are ensured to meet a minimum requirement of productivity (Summers 2008). While certainly appealing, the blunders and earmarks that characterized the recent stimulus packages suggest that even the internet and advanced management techniques cannot ensure against political shenanigans and defalcations (de Rugy 2010; Newton-Small & Scherer 2009). Furthermore, even if modern proponents of Keynesianism solve the public choice critiques, they still have failed to address the even more devastating critiques. Horwitz (2010a) stresses the importance of the epistemic problem faced by stimulus programs, "…the important question is not 'how many jobs?' *but 'which jobs?'* Jobs are easy to create; the right jobs are not and require the distributed intelligence of the marketplace."

Despite some of the valiant attempts to address and account for past critiques of Keynesian ideas, when a crisis hits, any progress is thrown out the window in favor of the politically popular Keynesian solutions. Despite the long history of unanswered critiques, and failed attempts that forced even the old proponents of Keynesianism to reject old Keynesian tenants, the promise of economic recovery through fiscal profligacy proves too enticing to resist. Modern Keynesians, when it comes to economically trying times, are making the very same mistakes as their predecessors. In response to the current crisis they have offered up essentially the same Keynesian nostrums. Just like the Keynesians of yesterday they seek the miracle of turning stone into bread (Mises 1948), but have failed to explain how this miracle is to happen. As many of the old critics of the Keynesian system have pointed out, they keep trying in vain. In this section we will demonstrate that the Keynesian framework failed to stand up to basic economic critiques in the past, and that modern manifestations of Keynesianism still fail this test, and thus are inappropriate and even pernicious, especially in a downturned economy.

3.1 The Framework

Little has been added to the traditional Keynesian framework since the 1950's. Despite its lackluster performance, and the inability of proponents to provide a microeconomic justification for it, stimulus is still the proffered solution for an economic downturn. Larry Summers (2010) directly makes the case for Keynesian remedies,

> *It is important to recognize that the ultimate consequences of stimulus for indebtedness depend critically on the macroeconomic conditions. When the economy is demand constrained, the impact of a dollar of tax cuts or expansionary investment will be at its highest and the impact on deficits at its lowest.*

As Keynes et al. (Macgregor 1932) argue, the solution for economic woes cannot be found in the private economy and government must step in to boost consumption in order to put the economy on the path to recovery. This same argument is once again being used to argue for Keynesian inspired stimulus. Paul Krugman (2010a) argues,

> *Penny-pinching at a time like this isn't just cruel; it endangers the nation's future. And it doesn't even do much to reduce our future debt burden, because stinting on spending now threatens the economic recovery, and with it the hope for rising revenues.*

Krugman's quote bears a close resemblance to Keynes (1932, 61),

> *The voices which – in such a conjecture – tell us that the path of escape is to be found in strict economy and in refraining, wherever possible, from utilizing the world's potential production, are the voices of fools and madmen.*

Larry Summers (2010) echoes this same sentiment, arguing that there is a strong case for temporary stimulus if there are rigid interest rates and excess capacity because the short-run multiplier is likely to be higher than average. Christina Romer (2009a) stresses the inability of the private sector to recover from the current economic crisis without the assistance of government directed stimulus,

> *With the dramatic fall in household wealth and the rapid spread of the downturn to our key trading partners, there was no realistic prospect that the private sector would generate a turnaround in demand any time soon. Thus, although stabilizing the financial system and helping distressed homeowners was essential, it would not be enough. We needed to bring in the other main tool that a government has to counteract a cataclysmic decline in aggregate demand: fiscal stimulus.*

Robert Frank (2009) chimes in as well, defending the case for stimulus,

> *The only remaining major component of aggregate demand is government spending. Stimulus proponents, following John Maynard Keynes, believe that increased government spending — financed by borrowed funds or printing new money — is the only way to bolster aggregate demand and end the downturn quickly. Recent results suggest that this strategy is working.*

Despite all these prominent economists defending stimulus today, the Keynesian case for stimulus has been carefully refuted, both in the past and in modern times. John Cochrane (2009) lays out three of the most poignant arguments against Keynesian stimulus,

> *First, if money is not going to be printed, it has to come from somewhere. If the government borrows a dollar from you, that is a dollar that you do not spend, or that you do not lend to a company to spend on new investment. Every dollar of increased government spending must correspond to one less dollar of private spending. Jobs created by stimulus spending are offset by jobs lost from the decline in private spending.*
>
> *Second, investment is "spending" every bit as much as is consumption. Keynesian fiscal stimulus advocates want money spent on consumption, not saved. They evaluate past stimulus programs by whether people who got stimulus money spent it on consumption goods rather than save it. But*

the economy overall does not care if you buy a car, or if you lend money to a company that buys a forklift.

Third, people must ignore the fact that the government will raise future taxes to pay back the debt. If you know your taxes will go up in the future, the right thing to do with a stimulus check is to buy government bonds so you can pay those higher taxes. Now the net effect of fiscal stimulus is exactly zero, except to raise future tax distortions. The classic arguments for fiscal stimulus presume that the government can systematically fool people.

So, Keynesian proponents must assume that government has better incentives and a better capacity, than the private sector, to direct resources to their most productive use. Eugene Fama (2009) echoes this point,

Even when there are lots of idle workers, government bailouts and stimulus plans are not likely to add to employment. The reason is that bailouts and stimulus plans must be financed. The additional government debt means that existing current resources just move from one use to another, from private investment to government investment or from investment to consumption, with no effect on total current resources in the system or on total employment.

Then Keynesians must assume that savings is an actual leakage from the economy, but that hardly is the case. Tyler Cowen (2010) argues, "[c]orporations with cash surpluses are not destroying real resources, nor are they stuffing cash in their mattresses. They are investing in financial assets." Rizzo (2010a) adds to this explanation,

…unemployment of resources, including labor, is not always pure idleness. We are living in conditions of real uncertainty. A bubble has burst, the domestic auto industry faces uncertain prospects, tax rates are on the way up – how far and in what respects is anyone's guess – we have just faced a possible healthcare transformation with its unique costs and taxes, European debt problems are becoming manifest, and more.

Finally, Keynesian proponents must also assume that people do not take into consideration that the stimulus must be paid back eventually in the form of higher taxes. In attempting to measure the multiplier effect of stimulus dollars during peacetime, Robert Barro (2009) got a number that was insignificantly different than zero, due to the fact that people foresee the growth in taxes to pay for the stimulus.

Mario Rizzo (2010b) questions the Keynesian tendency to disband economic theory during downturns, asking "[w]hen does the Keynesian moment end — and the ordinary laws of economics retake the stage?" Rizzo (2010c) also questions the ability of government to actually cut government spending during good economic times to make up for financial profligacy during economic downturns due to entrenched special interest groups. If there are any reductions, they "…will be half-measures taken half-heartedly. *So over the long run the size and scope of government will expand permanently*" (Rizzo 2010d). Freedman et al. (2010) find that without a political regime that ensures that deficits do not continue to grow once the economy improves, the long-run costs of deficit spending during a recession can exceed the short-run benefits.

The Keynesian model, at its best is still an over-simplified and overly aggregated schematic that is built upon highly idealized assumptions of benevolence and omniscience. A severe problem for Keynes, whose main criticisms of the classical school, according to his biographer Robert Skidelsky (2009, 82), was that it "…used models which assumed certain things which did not occur in the real world…" As Hayek ([1966] 1995, 242) noted on the aggregation of Keynes's model,

> *His final conceptions rest entirely on the belief that there exist relatively simple and constant functional relationships between such 'measurable' aggregates as total demand, investment, or output, and that empirically established values of these presumed 'constants' would enable us to make valid predictions. There seems to me, however, not only to exist no reason whatever to assume that these 'functions' will remain constant, but I believe that microtheory had demonstrated long before Keynes that they cannot be constant but will change over time not only in quantity but even in direction.*

Keynes, while criticizing classical economists for assuming full employment, embraced an equally unrealistic assumption of full unemployment of all resources. As Hayek ([1966] 1995, 243) argues, this assumption,

> *…is not only at least as unlikely to be true in fact as the former; it is much more misleading. An analysis on the assumption of full employment, even in if the assumption is only partially valid, at least helps us to understand the functioning of the price mechanism, the significance of the relations between different prices and of the factors which lead to a change in these relations. But the assumption that all goods and factors are available in excess makes the whole price system redundant, undetermined and unintelligible. Indeed, some of the most orthodox disciples of Keynes appear consistently to have thrown overboard all the traditional theory of price determination and of distribution, all that used to be the backbone of economic theory, and in consequence, in my opinion, to have ceased to understand any economics.*

Keynes also did not foresee the public choice issues that emerge in contemporary democratic settings in which public policy is actually formed and implemented, instead assuming that policy was crafted by a small group or relatively wise and enlightened people (Buchanan, Burton & Wagner 1978, 16). The case for Keynesianism was also grounded in a closed economy model, and as Niall Ferguson (2009) points out, we are in "…a globalized world, where uncoordinated profligacy by national governments is more likely to generate bond-market and currency-market volatility than a return to growth."

The Keynesian model also fails to account for how government intervention in the economy distorts the incentives to invest. Not only did Keynesian inspired stimulus during the Great Depression fail to help the economy improve (Romer 2009b), Keynesian policies adversely affected investment because businessmen were scared to undertake long-term projects with the uncertainty created by the constant political manipulation of the economy (Higgs, 1997). People make decisions based upon relative prices, and when government intervenes into the economy, distorting relative prices, it incentivizes people to behave in unpredictable ways, leading to what economists refer to as the problem of 'unintended consequences.' Keynesian models avoid taking into account these relatives price effects, and the toll they take on the economy. As Lee Ohanian (2009) argues,

> *…the old Keynesian model does not come anywhere close to meeting today's standards for economic analysis. Economics is about incentives: the incentives for households to work, consume and save, and the incentives for business to hire workers and invest in plants and equipment. These incentives are remarkably absent from the macroeconomics of yesteryear. And modern economic analysis shows that the impact of government spending on the economy depends on what it is being spent on and how it ultimately is paid for.*

3.2 The Causes of the Crisis

There is a wide range of explanations offered for the current financial crisis. Some of the competing narratives advanced are new, relying on modern conditions or innovations for their explanation, while others echo explanations that have been advanced to explain past economic downturns. The traditional Keynesian explanation for the severity of the Great Depression, as outlined in Keynes et al.'s *Times of London* letter, that blames private sector spending, is once again being advanced, as Martin Wolf (2010) argues "[w]hat we are seeing, in short, is an epidemic of private sector frugality…"

Some of the most widely cited explanations include blaming complex and poorly understood financial instruments (Foster 2009) and private sector greed (Kotlikoff 2010, 31). While arguments for greed and stupidity are tempting, they fail to explain why these components of human nature, which are omnipresent, all of a sudden lead to a financial meltdown, and thus fail to adequately explain the root causes, leading to misguided policy recommendations. Similarly, some explanations focus on the deregulation of the financial sector, which in turn let loose private sector greed (Skidelsky 2009, 44). In an op-ed in the *New York Times*, Krugman (2009) blames the deregulation of the financial system for partially being at fault for the onset of the financial crisis,

> *America emerged from the Great Depression with a tightly regulated banking system. The regulations worked: the nation was spared major financial crises for almost four decades after World War II. But as the memory of the Depression faded, bankers began to chafe at the restrictions they faced. And politicians, increasingly under the influence of free-market ideology, showed a growing willingness to give bankers what they wanted…And the bankers — liberated both by legislation that removed traditional restrictions and by the hands-off attitude of regulators who didn't believe in regulation — responded by dramatically loosening lending standards. The result was a credit boom and a monstrous real estate bubble, followed by the worst economic slump since the Great Depression.*

Similarly, the lack, or insufficiency, of regulation is often advanced as an alternative, or contributing factor to the financial crisis as well (Bernanke 2010). Contrary to this claim, many economists have actually found contradictory, complex, and constantly changing regulation led to the financial industry troubles. Klein (2010) challenges this explanation by looking at some basic measures of the magnitude of financial regulation, such as the number of federal registry pages, the amount of federal spending on finance and banking regulation, as well as other metrics for the growth of government. Klein finds no trend to indicate that there actually was a period of decline, or even lack of growth, in government programs or financial regulation. The deregulation and free market sentiments were stronger in rhetoric than in actual practice.

Levine (2010a) stresses that innovation is a constant in all industries, and that yes, it does have risks and sometimes leads to product misuse, but that claiming financial innovation inhibits economic growth is like claiming that medical research does not advance human health because sometimes drugs are abused. Financial innovation, just like innovation in any other sector, is a necessary component of economic growth.

Another explanation offered for the current crisis is large capital inflows from foreign nations, due to a global savings glut, lowered interest rates and led to a rise in mortgages and a decline in lending standards (Greenspan 2010). Taylor (2009) finds that there is no empirical evidence to support this argument, and that the evidence actually points to a saving shortage. The "savings glut," even if it were conceivable in a world of scarcity, to the extent it exists outside of the United States was offset by the saving shortage in the United States.

A more comprehensive understanding of the financial crisis requires taking a broader perspective of the political economy of the events preceding the crisis. Only with this perspective can the role that government, and in particular Keynesian inspired policies, played in creating the regulatory and institutional conditions that set the stage for the real estate bubble and its subsequent collapse be seen. In this section we discuss what we hold to be the primary causes of the start and continuation of the financial crisis; namely inflationary policies, policies that led to the housing bubble, and the regulatory regime.

3.2.1 Inflationary Policies

In response to the recession of 2001, the Federal Reserve pushed down the federal funds rate, the primary target rate of the Federal Reserve, from 6% in January of 2001, where it had hovered in between 4.5 and 6.5% since the end of 1994, to hover around 1% by around July of 2003, it's lowest rate in 40 years (Roberts, 2010). It even reached negative rates when adjusted for inflation (FRED). The artificially low interest rates and inflation spurred investments for which the economy did not have real resources to complete. In other words, the cheap availability of loans encouraged entrepreneurs to collectively make investments that exceeded the resources of the economy, and the productive and technological capacities of the economy. While an un-manipulated interest rate would have risen, operating as a brake on the economy to curtail malinvestment and overinvestment, and would have allocated loanable funds to only their most valuable projects (Hayek 1975 [1933], 94), the artificially low interest rates prevented this rationing device from operating to choke off superfluous investment.

Taylor (2009) finds that the excess monetary expansion was the main cause of the boom and the subsequent bust. Using the Taylor rule, a monetary policy rule that accounts for inflation and the interest rate, a rule that the Federal Reserve has followed for roughly the last 20 years, Taylor compares the actual federal funds rate with the federal funds rate that should have been targeted according to the rule. Taylor finds that there was a significant deviation from the prescriptions of the Taylor rule, indicating that monetary policy was too easy according to what historical experience dictates it should be. Using a model, Taylor then estimates what housing starts would have been had the Taylor rule been followed, and then charts them against the actual housing starts, showing that the low interest rates were indeed a key factor in the housing bubble.

Europe offers further empirical evidence to indict inflationary policies in the financial crisis. Rajan (2010) argues "[c]ountries that had strongly negative real policy rates – Ireland and Spain are primary exhibits – had a housing boom and bust, while countries like Germany with low inflation, and therefore higher real policy rates, did not." A working paper by two authors at the European Central Bank (Maddaloni and Peydro 2010) establishes a causal connection between the inflationary policies of the ECB and the FED and the subsequent decline in commercial, mortgage and retail lending standards.

This was also recognised by Mises (1948) when he said, "John Maynard Keynes, late economic adviser to the British Government, is the new prophet of inflationism." The arguments by modern Keynesians are similar to the original arguments Keynes himself made. As Mises (1949, 787-793) also wrote, "Keynes did not add any new idea to the body of inflationist fallacies, a thousand times refuted by economists… He merely knew how to cloak the plea for inflation and credit expansion in the sophisticated terminology of mathematical economics." Economists like Mises knew the true effects of inflation.

Inflation, as Hayek argued, is a lot more destructive than just a rise in the general price level. Inflation necessarily creates changes in relative prices, causing people to adjust their behavior, which in turn creates even more distortions that ripple through the economy, pushing the economy to a position that is inconsistent with the underlying preferences and technology. Much of the concerns of Keynesians, such as unemployment, are often caused by this inflationary distortion of relative prices. As Hayek (1974) noted in his Nobel lecture, "We have indeed good reason to believe that unemployment indicates that the structure of relative prices and wages has been distorted (usually by monopolistic or governmental price fixing), and that to restore equality between the demand and the supply of labour in all sectors changes of relative prices and some transfers of labour will be necessary."

The problem with inflation, and why it adversely affects relative prices, is that it ripples through the economy distorting the information signals which prices represent. Hayek (1945) carefully detailed the important role that prices play in the economy by transmitting dispersed knowledge of time and place to the relevant economic actors. As Hayek (1941, 64) notes,

> *But general price changes are no essential feature of a monetary theory of the trade cycle; they are not only unessential, but they would be completely irrelevant if only they were completely "general"—that is, if they affected all prices at the same time and in the same proportion. The point of the real interest to trade cycle theory is the existence of certain deviations in individual price relations occurring because changes in the volume of money appear at certain individual points; deviations, that is, away from the position that is necessary to maintain the whole system in equilibrium.*

Easy money policies fuel speculation and investments that fall beyond what would be encouraged by un-manipulated market prices. Savings represents the amount of future goods that consumers desire, and the interest rate adjusts to allocate the available savings among the competing investment projects. Excessive investment in a stable monetary regime, as mentioned above, would be discouraged by rising interest rates. In an inflationary environment this check on investment never operates, and thus, more investment projects are undertaken then dictated by consumers' desires for future goods. This leads to an eventual economic bust as investors realize that they undertook investments for which consumers were not actually leaving unconsumed (i.e. saving) enough real resources for all of them to be carried out. A policy of accelerating inflation may delay this bust, but the heavy economic and thus political costs of increasing inflation will eventually force a shift in policy that will unmask the investment errors. During the bust resources will be channeled back into the projects that are in alignment with customer preferences and savings, absent further distortionary monetary or fiscal policy (see Garrison 2001).

Inflation also bears additional costs, besides the relative price manipulations that undermine the epistemic function of prices. There are costs of avoiding inflation, which involve both the cost of tax lawyers and accounts, as well as the economic cost of investors refraining from particular investments, or altering their investment and consumption plans in order to obtain favorable tax treatment. There is the search for otherwise unproductive assets whose use lies solely in their ability to hold value during inflationary times. There are 'Shoe leather costs,' which are the costs associated with people having to run to the bank more frequently during inflationary times. In addition, there are also 'Menu costs' which comprise the costs associated with price changes necessitated by inflation, such as having to reprint menus in order to reflect higher prices. Accountancy costs emerge because the relative price distortions don't equally effect all goods at the same time, so it undermines the accuracy of the information conveyed by financial statements. Accountancy costs are exacerbated by the fact that these distorted financial statements are then used to make future plans, meaning that inflationary distortions are carried forward. Finally, bouts of inflation also undermine the reliability of contracts, making private actors more wary of engaging in long-term contracts, as well as raising the costs of contract negotiation and enforcement.

3.2.2 Housing Bubble

The easy money and artificially low interest rates spurred a bubble in the housing sector, where the ten-city composite index realized an average annualized rate of return of 13% from June 2001 to June 2006 (Murphy 2008). There were several factors that concentrated the excess currency, or overinvestment, into the housing sector. First, was Fannie Mae and Freddie Mac, both government sponsored enterprises that were chartered by Congress with the intent of providing liquidity, stability, and affordability to the mortgage market in order to promote access to mortgage credit (Fannie Mae Charter Act 1954; Federal Home Loan Mortgage Corporation Act 1970). In other words, the political purpose of these government sponsored enterprises was putting mortgages into the hands of people who would otherwise have been denied a mortgage in the free market due to insufficient income, an unstable job, or lack of assets (c.f. Block et. al 2008). In fact, these agencies were given a target requirement for the number of loans they made to borrowers with below median income for the area, which rose to 55% in 2007 (HUD). They accomplish this by participating in the secondary market for mortgages or by buying up bundled mortgages from banks, either through outright purchase or by swapping them for a mortgage-backed security that promises the originators a guaranteed rate of return. Both of these courses of action shelter the originating bank from the risks of its mortgages as the risk is transferred to Fannie and Freddie.

Fannie and Freddie were equipped with several privileges unavailable to market institutions in order to carry out this goal. One of the most favorable privileges was that Fannie and Freddie were implicitly backed by the U.S. taxpayers, meaning that while the stockholders maintained any gains, there was an implicit federal guarantee for any losses that resulted from the mortgages. Privatizing gains and socializing losses obviously in and of itself sets up the perverse incentives for excessive risk taking. Fannie and Freddie were also able to borrow funds at a rate that was only slightly above the federal funds rate, a rate that was significantly lower than the rate available to market institutions (Bernanke 2007). With these special provisions, Fannie and Freddie were in control of a combined $1.8 trillion in assets by 2003 (Frame and White, 2005). To put that in perspective, based purely upon assets, they were respectively the 2nd and 3rd largest companies in the U.S. at that time. Between 1998 and 2003 when the housing market began to soar, they were the most frequent buyers of loans (Roberts, 2010). In return for these privileges, government ensured that they would have the ability to influence the policies of Fannie and Freddie through the presidential appointment of five members of both Fannie's and Freddie's board of directors and through the Department of Housing and Urban Development.

Another factor that channeled overinvestment into the housing industry was tax code manipulation. To encourage house ownership, the U.S. government has kept an extremely popular deduction for mortgages, while renting has not received similar treatment (Norberg, 2009). In 1997, home ownership was again encouraged through the tax code through the abolition of the capital gains tax on real estate investments, while it was maintained for other types of investments (Roberts, 2010). Just this change in 1997 is estimated to have increased the number of home sold by 17% (Bajaj and Leonhardt, 2008). Nobel Laureate Vernon Smith (2007) wrote that the 1997 tax break was the cause that fueled the "mother of all housing bubbles…"

Of course, the view that government programs that distorted relative prices in order to influence private actors' decisions is not new, in fact, Henry Hazlitt in his famous *Economics in One Lesson* ([1946] 1979, 47) warned that,

> *Government-guaranteed home mortgages, especially when a negligible down payment or no down payment whatever is required, inevitably mean more bad loans than otherwise. They force the general taxpayer to subsidize the bad risks and to defray the losses. They encourage people to "buy" houses that they cannot really afford. They tend eventually to bring about an oversupply of houses as compared with other things. They temporarily overstimulate building, raise the cost of building for everybody (including the buyers of the homes with the guaranteed mortgages), and may mislead the building industry into an eventually costly overexpansion. In brief in the long run they do not increase overall national production but encourage malinvestment.*

This goes beyond just the housing bubble. Any artificial changes to the rate of interest will have a similar, and often devastating, effect. Hazlitt (1959, 385) in his almost point-by-point refutation of Keynesian fallacies in *The Failure of the "New Economics,"* where he notes,

> *It is hard to believe that Keynes is as niave as he pretends, and that he is not laughing up his sleeve. The rate of interest—the valuation of time and all investments—is to be taken out of the market and put completely in the hands of the state. But Keynes ignores the complete interconnectedness of all prices. This especially includes the price of capital loans, any State tinkering with which must necessarily affect and distort all prices and price relationships throughout the economy.*

It is important to remember that the downturn is the recovery, the boom is where the problems emerge. The recession that results in the popping of the bubble is the market correcting itself. Thus as Rothbard (1962, 860) notes,

> *It should be clear that any governmental interference with the depression process can only prolong it, thus making things worse from almost everyone's point of view. Since the depression process is the recovery process, any halting or slowing down of the process impedes the advent of recovery. The depression readjustments must work themselves out before recovery can be complete. The more these adjustments are delayed, the*

> *longer the depression will have to last, and the longer the recovery is postponed. For example, if the government keeps wages rates up, it brings about permanent unemployment. If it keeps prices up, it brings about unsold surplus. And if it spurs credit expansion again, then new malinvestment and later depressions are spawned.*

Thus, any attempts to use government to interfere with the market adjustments will make things worse. These are exactly the policies that the Keynesians prescribe to, and to which we now turn.

3.2.3 Regulatory Regime

During a recession, whenever laws and regulations become highly sensitive to political manipulation or popular opinion, oftentimes the first people blamed as the culprits are businessmen. When popular sentiments such as this are combined with a political administration that demonstrates a willingness to intervene in the economy in order to appease these sentiments, it creates a highly unpredictable business atmosphere. So precisely when political officials should be setting an environment in which entrepreneurs feel safe to undertake investments, they often create an atmosphere that discourages investment. Robert Higgs (1997) finds that this phenomena, known as 'regime uncertainty,' helps explain the magnitude and length of the Great Depression because of the constantly changing regulatory and legal framework in response to the recession. Policies that have been pursued before and during the current financial crisis have led to greater uncertainty for investors as well.

Ross Levine (2010b) finds that policymakers and regulators had a hand in creating conditions that led to the financial crisis by maintaining policies that encouraged destabilizing policies. Capital requirement regulations required investors to use the SEC created National Recognized Statistical Rating Organizations (NRSRO) for security ratings. The NRSRO has limited competition in the credit rating industry to just a few key players. In 2000 there were only three recognized agencies and no justification or list of criteria for becoming recognized (White, 2009). By sheltering the credit ratings from competition, entry and innovation, these regulations reduced the reputational incentives of the protected rating agencies to accurately rate securities. Other policies such as the *Recourse Act,* which revised the *Basel* regulations, made it so banks had the incentive to hold mortgage-backed securities over individual mortgages and commercial loans by changing their relative capital reserve requirements (Friedman 2009; Roberts 2010). As Friedman (2009) stresses, regulation homogenizes, mandating what regulators believe to be prudent banking practices on the entire system. If the regulators are wrong, the whole system is at risk. One of those misguided policies that encouraged systematic risk was the de facto policy of the federal government to bailout large or politically connected firms over the past three decades (Roberts 2010). Following an implicit policy to bail out firms if they suffer extreme losses, but allowing them to enjoy all upside profits, mollifies the prudence inspired by the profit and loss system, encouraging more risky behavior.

In addition to regulations that played a role in leading to the financial crisis, there has been a flux of new regulations after the initial onset of the financial crisis that have created uncertainty for investors. The Obama administration's continuing lambasting of profit-seeking businessmen has in particular created an atmosphere of uncertainty. Alan Meltzer (2010), points to several factors that increased economic uncertainty in the wake of the start of the financial crisis. The passage of the healthcare bill produced uncertainty for employers, especially those considering hiring new employees, as there was significant doubt about the CBO's estimates of the total cost that would be borne by employers. In addition, the estimates for the healthcare bill also depended upon cutting spending in politically popular areas in the future and other generous assumptions, creating uncertainty about future tax hikes or inflation in order to fund it, along with rising uncertainty about future Social Security and Medicare obligations (Holtz-Eakin 2010). The auto bailouts, which transgressed the rule of law in order to hand out political favors to politically powerful unions over bondholders, put further doubts into the minds of investors (King Jr. 2009). Amity Shlaes (2010), compares the adverse effects of government induced uncertainty in the Great Depression as well as following the onset of the financial crisis, concluding that,

> *Mr. Geithner is gradually discovering that to recover, the market needs a specific kind of confidence. It is not something Washington can hand down. It is not even demand confidence—the confidence of the consumer who wants to shop. The confidence relevant to recovery is the confidence of the investor and the saver. It comes only when an administration in Washington demonstrates reliability and restraint.*

These insights that government intervention into the economy can inhibit investors from investing and preventing recovery were stressed by past critics of Keynesianism. These flaws in the policy prescriptions stemming from the Keynesian ideas have long been refuted. Economists have seen through the inconsistencies since Keynes's *General Theory* itself. As economist David McCord Wright (1958) noted,

> *If consistency is the bane of little minds, Lord Keynes had certainly a great one. No one who studies the work of John Maynard Keynes can fail to be impressed by the frequent brilliance of his insights and the usefulness of many of his tools of analysis. But he lacked that sober quality which causes a man to sit down and carefully consider the consistency of his various successive theories and pronouncements.*

Chicago economist Frank Knight (1937) in his review of the *General Theory* had little respect for Keynesian policy prescriptions from the view of economics when he said, "I can only comment that phrases like socialization of investment, with no indication of what procedure is in mind, sound (to me) more like the language of the soap-box reformer than that of an economist writing a theoretical tome for economists." This seems relevant for today with many of the modern proposals from modern Keynesians.

Economists F.A. Hayek and William Hutt had legitimate fears about the outcomes of government intervention inherent in the Keynesian policies. Hayek (1941) noted, "[a]re we not even told that, 'since in the long run we are all dead,' policy should be guided entirely by short-run considerations? I fear that these believers in the principle of *après nous le deluge* may get what they have bargained for sooner than they wish." And Hutt (1954) worried,

> *Actual policies have, for decades, been based precisely upon the politically attractive rule, justified by Keynesian teaching, that disharmony in the wage-rate structure must not be tackled but offset; whilst the current tendency is to assume dogmatically with no examination of the institutional and sociological factors involved, that to advocate wage and price adjustments is to recommend the conquest of the moon.*

These fears have often manifested themselves in reality when Keynesian policies were implemented. Henry Morgenthau, the treasury secretary under FDR, said in 1939, "[w]e are spending more money than we have ever spent before, and it does not work...We have never made good on our promises...after eight years of this administration we have just as much unemployment as when we started...and an enormous debt, to boot" (Schram 2009). This lead Hazlitt (1995 [1960], 10) to wonder, "[b]ut whatever the full explanation of the Keynesian cult, its existence is one of the greatest intellectual scandals of our age."

4 Conclusion: Lack of Creativity

In the progression of economic ideas, some ideas are discarded as theoretically unsound and empirically invalid. Keynesianism is one of those ideas that was found lacking and was therefore appropriately discarded. Yet, it has shown a bewildering tendency to reemerge during times of economic hardship, precisely when a return to basic economics is needed most. Its promises to turn stone into bread are too enticing to refrain from entertaining. As Peter Boettke (2010) stresses, "what we need in extraordinary times is simple economics; as simple economics is far from simple minded. In times of crisis it is too often assumed we need extraordinary and complex theories but what we really need is cool-headed and basic economic principles. As economists we tell our students in principles course that incentives matter and we should know this is true even in times of crisis. When we forget and discard the basic principles of economics we make the very crisis we wish to solve worse."

Throughout history fiscal profligacy and government interventionism have caused the decline and the downfall of many societies. While the theories that promise abundance out of scarcity are intoxicating, they are based upon false premises, which violate the fundamental lessons of basic economics. Heedless attempts to overturn the basic laws of economics with ungrounded Keynesian policies will only lead us down the dangerous path of deficits, debt and debasement.

That we find ourselves once again travelling down the road of deficits debt and debasement is not just a failure that can be pinned on new Keynesians who have failed to reject conclusions of Keynes's system that fail to pass basic microeconomic inspection. Economists who have failed to explicate the theoretical and historical failure of

Keynesianism in a fashion that would be understood by the economic profession, politicians, and the public are also to be blamed. The revival of recycled Keynesian ideas has not instigated a serious reformulation of the way in which basic economics is articulated and conveyed, but a simple duplication of arguments already rendered in the past. Both sides of the debate have suffered from a lack of intellectual creativity, as well as a failure to talk on the same terms.

Similar to the debate between Malthus and Ricardo (see Maclachlan 1999), the debate between Keynesian proponents and opponents have not reached resolution primarily due to the lack of realization that they are using two fundamentally different styles of economic argument. While Keynes criticized the mathematization of economics and warned against the excessive reliance on econometrics, his aggregative formulas, which abstracted out of real essential elements in the economy, were highly translatable into mathematics and econometrics.

What is needed is a radical rethinking of the monetary institutions in society, and the binding rules on fiscal policies. Some of the foremost economic scholars of the 20th century, Nobel Laureates F.A. Hayek, James M. Buchanan and Milton Friedman all tried to creatively seek ways to bind fiscal and monetary authorities, especially when these authorities act in concert, engendering fiscal profligacy and expansion of government. Each one, in his own way, ended up rejecting the possibility of controlling government spending. Hayek (1976) proposed allowing competitive money issue. Friedman (2007) in an interview published posthumously, advocating handing the responsibilities of the Federal Reserve over to a computer. Finally, Buchanan (1962, 172), suggests that our monetary institutions have so utterly failed us that a complete restricting and constitutionalization of our monetary institutions are needed, not just marginal adjustments. . Market forces would then spontaneously work in order to adjust the price level. As the general price level rose, people would exchange currency for bricks and as the general price level fell, people would exchange bricks for currency.

This kind of creative thinking has been carried forward by monetary theorists George Selgin and Larry White (1994), who wrote a summary of the major advances in free banking scholarship for the *Journal of Economic Literature*. Laurence Kotlikoff (2010) takes a novel approach in his book *Jimmy Stewart is Dead* as well, recognizing that loose monetary policy helped lead up to the financial crisis, and that fiscal profligacy is not a viable long run remedy for it either.

Given the monetary mischief and fiscal irresponsibility that has characterized modern social democratic societies, the choice before us is how to get back on a policy path of sound money and fiscal responsibility. This is a choice over rules and institutional structures. We are confronted, as Gerald O'Driscoll has put it, with the choice of either free banking, narrow banking, or no banking. What we cannot do is continue down our current policy path. Creative thought among the best and brightest political economists of our age must be directed on finding that set of rules which effectively bind the hands of the fiscal authority, and finding the alternative institutional arrangements for money and finance which will eliminate the ability of the state to engage in monetary mischief. In this regard, as in some many others, we cannot simply point backwards to the work of Hayek, Friedman and Buchanan, but we must begin with their work and push it forward in time to address our problems in our time.

This lack of creativity on both sides cannot be ignored. We have pointed out why we believe Keynesian ideas are the wrong way to go but this does not change the fact that the supporters of these ideas, then and now, are extremely smart people. It is beyond the purpose of this paper to explain why the ideas persist but what we do want to stress is that if we want to convince them of the flaws in the Keynesian system then neither of us can continue to make the same arguments that we have made in the past. We must push forward in new ways to strengthen our position.

The déjà vu we are currently living through is dangerous. Fortunately, but perhaps even more unnerving, is that it is also unnecessary. The lessons of the past should be learned before the same mistakes are made yet again. Political economy has the answers, if anyone is willing to listen.

References

Bajaj, Vikas and David Leonhardt (2008, December 18). Tax break may have helped cause housing bubble. *The New York Times*. Retrieved online July 14, 2010, available at: http://www.nytimes.com/2008/12/19/business/19tax.html

Barro, Robert (2009, January 22). Government spending is no free lunch: Now the democrats are peddling voodoo economics. *The Wall Street Journal*. Retrieved online August 10, 2010, available at: http://onlinewsj.com/article/SB123258618204604599.html

Beaulier, Scott and Peter J. Boettke (2009, November 16). Hiding debt just a juggling trick. Independent Institute. Retrieved online August 27, 2010. Available at: http://www.independent.org/newsroom/article.asp?id=2660

Bernanke, Ben S. (2010, January 3). Monetary policy and housing bubble. *Annual Meeting of the American Economic Association*. Retrieved online July 3, 2010, available: http://www.federalreserve.gov/newsevents/speech/bernanke20100103a.htm

Bernanke, Ben S. (2007, March 6). GSE portfolios, systemic risk, and affordable housing. Speech before the Independent Community Bankers of America's Annual Convention and Techworld, Honolulu, Hawaii, via satellite. Retrieved online August 11, 2010, available at: http://www.federalreserve.gov/newsevents/speech/bernanke20070306a.htm

Besley, Tim, Christopher Pissarides Marcet, Danny Quah, Meghnad Desai, Andrew Turnbull, Orazio Attanasio, Costas Meghir, John Vickers, John Muellbauer, David Newbery, Hashem Pesaran, Ken Rogoff, Thomas Sargent, Anne Sibert, Michael Wickens, Roger Bootle and Bridget Rosewell (2010, February 14). *The Sunday Times.* Retrieved online August 11, 2010, available at: http://www.timesonline.co.uk/tol/comment/letters/article7026234.ece

Block, Walter, Nicholas Snow, and Edward Stringham (2008). Banks, insurance companies, and discrimination. *Business and Society Review,* 113(3): 403-419.

Boettke, Peter J. (2010, February 22). Simple economics is NOT necessarily simple-minded economics. *Coordination Problem*. Retrieved online August 10, 2010, available at: http://www.coordinationproblem.org/2010/02/simple-economics-is-not-necessarily-simpleminded-economics.html

Boettke, Peter J. (2009a, November 7). Paul Krugman and Scott Sumner -- who is nominally misguided or speaking nominal nonsense? *Coordination Problem*. Retrieved online August 27, 2010. Available at: http://austrianeconomists.typepad.com/weblog/2009/11/paul-krugman-and-scott-sumner-who-is-nominally-misguided-or-speaking-nominal-nonsense.html

Boettke, Peter J. (2009b, December 18). Jobless recovery: Or why macroeconomics is bad for the brain. *Coordination Problem*. Retrieved online August 27, 2010. Available at: http://austrianeconomists.typepad.com/weblog/2009/12/jobless-recovery-or-why-macroeconomics-is-bad-for-the-brain.html

Buchanan, James M. (1962). Probability: The criterion of monetary constitutions. *In Search of a Monetary Constitution*. Ed. Leland B. Yeager. London: Oxford University Press p. 155 – 183.

Buchanan, James M. (2001[1986]). Ideas, Institutions and Political Economy. *The Collected Works of James M. Buchanan*, Vol. 19. Indianapolis, Indiana: Liberty Fund Inc.

Buchanan, James M. and Richard E. Wagner (2000[1977]). *Democracy in Deficit: The Political Legacy of Lord Keynes*. The Collected Works of James M. Buchanan Vol. 8. Indianapolis, IN: Liberty Fund, Inc.

Buchanan, James M., John Burton and Richard E. Wagner (1978). *The Consequences of Mr. Keynes.* Great Britian: The Institute of Economic Affairs, Hobart Paper 78.

Cochrane, John (2009). Fiscal stimulus, fiscal inflation, or fiscal fallacies? *Working Paper*. Retrieved online August 10, 2010, available at: http://faculty.chicagobooth.edu/john.cochrane/research/Papers/fiscal2.htm

Cowen, Tyler (2010, July 8). Why are corporations saving so much? *Marginal Revolution*. Retrieved online August 8, 2010, available at: http://www.marginalrevolution.com/marginalrevolution/2010/07/why-are-corporations-saving-so-much.html

de Rugy, Veronique (2010, September 8). Obama stimulus money goes where needed least. Bloomberg. Retrieved online September 10, 2010. Available at: http://www.bloomberg.com/news/2010-09-09/obama-stimulus-funds-go-where-need-is-low-commentary-by-veronique-de-rugy.html

Ebeling, Richard M. (2010, July 10). Still hearing defunct economists in the air: Krugman's misplaced attack on Hayek. Think Markets. Retrieved online August 11, 2010, available at: http://thinkmarkets.wordpress.com/2010/07/10/still-hearing-defunct-economists-in-the-air-krugmans-misplaced-attack-on-hayek/

Fama, Eugene (2009, January 13). Bailouts and stimulus plans. *Fama/French Forum*. Retrieved online August 10, 2010, available at: http://www.dimensional.com/famafrench/2009/01/bailouts-and-stimulus-plans.html

Fannie Mae Charter Act of 1954, 12, U.S.C., §1716

Federal Home Loan Mortgage Corporation Act of 1970, 12, U.S.C., §1451

Ferguson, Niall (2009, February 6). Keynes can't help us now: Governments cling to the delusion that a crisis of excess debt can be solved by creating more debt. *Los Angeles Times*. Retrieved online July 12, 2010, available at:

http://articles.latimes.com/2009/feb/06/opinion/oe-ferg6

Foster, J.D. (2009, October 22). Understanding the great global contagion and recession. *The Heritage Foundation*. Retrieved online July 3, 2010, available: http://www.heritage.org/Research/Reports/2009/10/Understanding-the-Great-Global-Contagion-and-Recession

Frame, Scott W. and Lawrence J. White (2005). Fusing and fuming over Fannie and Freddie: How much smoke, how much fire? *Journal of Economic Perspectives* 19(2): 159-184

Frank, Robert (2010, August 22). Don't let the stimulus lose its spark. *The New York Times*. Retrieved online August 11, 2010, available at: http://www.nytimes.com/2009/08/23/business/economy/23view.html

FRED, Federal Reserve Economic Data. Federal Reserve Bank of St. Louis: Board of Governors of the Federal Reserve System. Retrieved online July 6, 2010, available at: http://research.stlouisfed.org/fred2/series/FEDFUNDS?cid=118

Freedman, Charles, Michael Kumhof, Douglas Laxton, Dirk Muir, Susanne Mursula (2010). Global Effects of Fiscal Stimulus During the Crisis. *Working Paper*. Retrieved online August 10, 2010, available at: http://www.stanford.edu/~johntayl/carnegie1march.pdf

Friedman, Jeffrey (2009, September 19). Bank pay and the financial crisis: G-20 accounting rules, not bank bonuses, put the system at risk. *The Wall Street Journal*. Retrieved online July 13, 2010, available at: http://online.wsj.com/article/SB10001424052970204488304574429293838639418.html?mod=djemEditorialPage

Friedman, Milton (2007, January 22). Milton Friedman @ rest. The Wall Street Journal. Retrieved online August 13, 2010, available at: http://online.wsj.com/public/article/SB116942792191783271-ZAcsMDZOCPy0yCR3ADsShGbx2vk_20070128.html?mod=blogs

Friedman, Milton (1966, February 4). Friedman and Keynes. Letters: Feb. 4, 1966. *Time* magazine. Retrieved online August 6, 2010, available at: http://www.time.com/time/magazine/article/0,9171,898916-2,00.html

Garrison, Roger W. (2001). Time and Money: The Macroeconomics of Capital Structure. New York: Routledge.

Gordon, R.J. (1990). What is New Keynesian Economics? *Journal of Economic Literature,* 28(3): 1115-1171

Greenspan, Alan (2010). *The Crisis*. Brookings Institute. Retrieved online July 3, 2010, available: http://www.brookings.edu/~/media/Files/Programs/ES/BPEA/2010_spring_bpea_papers/spring2010_greenspan.pdf

Gregory, T.E., F.A. von Hayek, Arnold Plant and Lionel Robbins (1932, October 19). Spending and saving: Public works from rates. *Times of London*. Retrieved online August 10, 2010, available at: http://thinkmarkets.files.wordpress.com/2010/06/keynes-hayek-1932-cambridgelse.pdf

Hayek, Friedrick A. (1931). *Prices and Production*. New York: Augustus M. Kelly, Publishers.

Hayek, Friedrick A. ([1933] 1975). *Monetary Theory and the Trade Cycle*. New York: Augustus M. Kelley.

Hayek, Friedrick A. (1941). *The Pure Theory of Capital.* Chicago, IL: The University of Chicago Press.

Hayek, Friedrick A. (1945). The use of knowledge in society. *American Economic Review* 35(4): 519-30.

Hayek, Friedrick A. ([1966] 1995). Personal recollections of Keynes and the 'Keynesian Revolution.' *Contra Keynes and Cambridge: Essays, Correspondence*. The Collected Works of F.A. Hayek ed. Bruce Caldwell

Hayek Friedrick A. (1974). The pretence of knowledge. *Noble Prize Lecture.* Retrieved online August 13, 2010, available at: http://nobelprize.org/nobel_prizes/economics/laureates/1974/hayek-lecture.html

Hayek, Friedrick A. (1976). *Denationalisation of Money*. London: Institute of Economic Affairs.

Hazlitt, Henry. (1959). *The Failure of the "New Economics": An Analysis of the Keynesian Fallacies.* New Rochelle, NY: Arlington House.

Hazlitt, Henry. Ed. (1995 [1960]). *The Critics of Keynesian Economics.* Irvington-on-Hudson, NY: The Foundation for Economic Education.

Hazlitt, Henry. (1979 [1946]). *Economics in One Lesson*. New York: Three Rivers Press.

Higgs, Robert (1997). Regime uncertainty: Why the Great Depression lasted so long and why prosperity resumed after the war. *The Independent Review*, 1(4): 561-590.

Holtz-Eakin, Douglas (2010, March 20). The real arithmetic of health care reform. *The New York Times*. Retrieved online July 13, 2010, available at: http://www.nytimes.com/2010/03/21/opinion/21holtz-eakin.html?_r=1&hp

Horwitz, Steven (1997). Understanding Say's Law of markets. *The Freeman: Ideas on Liberty* 47(1). Retrieved online August 12, 2010, available at: http://www.thefreemanonline.org/featured/understanding-says-law-of-markets/

Horwitz, Steven (2010a, February 7). The microeconomics of government stimulus spending and why Bastiat matters. *Coordination Problem*. Retrieved online August 10, 2010, available at: http://www.coordinationproblem.org/2010/02/my-few-days-of-infamy.html

Horwitz, Steven (2010b, August 23). Krugman's way too simple model. Coordination Problem. Retrieved online August 29, 2010. Available at: http://www.coordinationproblem.org/2010/08/krugmans-waytoosimple-model.html

HUD. Overview of the GSEs' housing goal performance, 2000-2007. *Housing and Urban Development*. Retrieved online July 14, 2010, available at: http://www.huduser.org/Datasets/GSE/gse2007.pdf

Hutt, W.H. (1954 [1995]). The significance of price flexibility. *South African Journal of Economics* (March): 40-51. Reprinted in Henry Hazlitt, ed. *The Critics of Keynesian Economics* (Irvington-on-Hudson: Foundation for Economic Education), 386-403.

Kates, Steven (1998). Say's Law and the Keynesian Revolution: How Macroeconomic Theory Lost it's Way. Northhampton, Massachusetts: Edward Elgar Publishing, Inc.

Keynes, John M. (1919[1971]). *The Economic Consequences of the Peace*. Reprinted in Donald Moggridge, ed. Donald Moggridge, ed. *The Collected Writings of John Maynard Keynes*, Vol. II. New York: MacMillan, St. Martin's Press.

Keynes, John M. (1930[1971]). *A Treatise on Money*. Vol. 1: The Pure Theory of Money. Reprinted in Donald Moggridge, ed. *The Collected Writings of John Maynard Keynes*. Vol. V. New York: MacMillan, St. Martin's Press.

Keynes, John M. (1930[1971]). *A Treatise on Money*. Vol. 2: The Applied Theory of Money. Reprinted in Keynes. Reprinted in Donald Moggridge, ed. *The Collected Writings of John Maynard Keynes,* Vol. VI. New York: MacMillan, St. Martin's Press.

Keynes, John M. (1932, November 21). *Activities 1931-9: World Crises and Policies in Britain and America.* Reprinted in Donald Moggridge, ed. *The Collected Writings of John Maynard Keynes,* Vol. XXI. New York: MacMillan, St. Martin's Press.

Keynes, John M. (1934, November 21). Poverty in plenty: Is the economic system self-adjusting? *The Listener* [Radio broadcast]. Reprinted in Donald Moggridge, ed. *The Collected Works of John Maynard Keynes*, Vol. 13: 485-492. New York: MacMillan, St. Martin's Press.

Keynes, John M. (1936[1957]). *The General Theory of Employment, Interest and Money*. London: MacMillan and Company Limited.

King Jr., Neil (2009, October 30). Politicians butt in at bailed-out GM. *The Wall Street Journal*. Retrieved online July 13, 2010, available at: http://online.wsj.com/article/SB125677552001414699.html

Klein, Peter (2010, January 28). The era of laissez-faire? *Organizations and Markets*. Retrieved online August 6, 2010, available at: http://organizationsandmarkets.com/2010/01/28/the-era-of-laissez-faire/

Knight, Frank H. (1937). Unemployment: and Mr. Keynes's revolution in economic theory. *The Canadian Journal of Economics and Political Science*: 100-123.

Kotlikoff, Laurence J. (2010). *Jimmy Stewart is Dead: Ending the World's Ongoing Financial Plague with Limited Purpose Banking*. Hoboken, New Jersey: John Wiley & Sons, Inc.

Krugman, Paul (2010a, June 20). Now and later. *The New York Times*. Retrieved online July 7, 2010, available at: http://www.nytimes.com/2010/06/21/opinion/21krugman.html

Krugman, Paul (2010b, August 29). Making it up. *The New York Times*. Retrieved online August 29, 2010. Available at: http://krugman.blogs.nytimes.com/2010/08/23/making-it-up/

Krugman, Paul (2009, December 13). Disaster and denial. *The New York Times*. Retrieved online August 11, 2010, available at: http://www.nytimes.com/2009/12/14/opinion/14krugman.html

Lane, Patrick, Bradford DeLong and Luigi Zingales (2009, March 10). Economist debate. *Economist*. Retrieved online August 12, 2010, available at: http://www.economist.com/debate/days/view/276

Leeson, Robert (1997). The eclipse of the goal of zero inflation. *History of Political Economy* 29(3): 445-496

Leeson, Robert (1999). Keynes and the "Keynesian" Phillips Curve. *History of Political*

Economy 31(3): 493-509.

Leijonhufvud, Axel (1968). *On Keynesian Economics and the Economics of Keynes.* London: Oxford University Press.

Levine, Ross (2010a, February 23). Financial innovation: This house believes that financial innovation boosts growth. *The Economist*. Retrieved online July 6, 2010, available at: http://www.economist.com/debate/days/view/471#pro_statement_anchor

Levine, Ross (2010b). An autopsy of the U.S. financial system. *National Bureau of Economic Research.* Working Paper 15956.

Lucas, Robert E. Jr. and Thomas J. Sargent (1978). After Keynesian macroeconomics. *Quarterly Review*. Federal Reserve Bank of Minneapolis.

Maclachlan, F. Cameron (1999). The Ricardo-Malthus debate on underconsumption: A case study in economic conversation. *History of Political Economy* 31(3): 563-574

Macgregor, D.H., A.C. Pigou, J.M. Keynes, Walter Layton, Arthur Salter and J.C. Stamp (1932, October 17). Private spending: Money for productive investment. *Times of London*. Retrieved online August 11, 2010, available at: http://thinkmarkets.files.wordpress.com/2010/06/keynes-hayek-1932-cambridgelse.pdf

Maddaloni and Peydro (2010). Bank risk-taking, securitization, supervision and low interest rates: evidence from the Euro area and the U.S. Lending Standards. *ECB Working Paper*.

Meltzer, Alan (2010). Why Obamaonomics has failed: Uncertainty about future taxes and regulations is enemy No. 1 of economic growth. *The Wall Street Journal*. Retrieved online July 14, 2010, available at: http://online.wsj.com/article/SB10001424052748704629804575325233508651458.html?mod=WSJ_Opinion_LEADTop#printMode

Mises, Ludwig von. (1948). Stones into bread, the Keynesian miracle. *Plain Talk,* Vol. 2, No. 6, pp. 21-27.

Mises, Ludwig von. (1949). *Human Action: A Treatise on Economics.* New Haven, CT: Yale University Press.

Mises, Ludwig von. (1952). *Planning for Freedom: Let the Market System Work.* Indianapolis, IN: Liberty Fund, Inc.

Murphey, Robert (2008). Can the Feds save the housing market? Numerous government policies caused or exacerbated the crisis. *The Freeman*, 58(5).

Newton-Small, Jay and Michael Scherer (2009). Does Obama have a double standard on earmarks? *Time* [magazine]. Retrieved online July 12, 2010, available at: http://www.time.com/time/politics/article/0,8599,1881855,00.html#ixzz0tTvEfwg1

Norberg, Johan (2009). *Financial Fiasco: How America's Infatuation with Home Ownership and Easy Money Created the Economic Crisis.* Washington D.C.: Cato Institute.

Ohanian, Lee (2009, June 10). The $787 billion mistake. *Forbes* magazine. Retrieved online August 10, 2010, available at: http://www.forbes.com/2009/06/09/american-recovery-reinvestment-act-roosevelt-opinions-contributors-depression.html

Papola, John and Russell Roberts (2010). *Fear the Boom and Bust* [Music Video]. Retrieved online August 6, 2010, available at: http://econstories.tv/home.html

Rajan, Raghuram (2010, September 14). Reviewing Krugman. *Fault Lines: Official Blog.* Retrieved online September 18, 2010. Available at: http://forums.chicagobooth.edu/faultlines?entry=24

Rizzo, Mario (2010a, February 6). Crowding out Brad DeLong. *ThinkMarkets*. Retrieved online August 10, 2010, available at: http://thinkmarkets.wordpress.com/2010/02/06/crowding-out-brad-delong/

Rizzo, Mario (2010b). Jeffrey Sachs and the Keynesian conundrum. *ThinkMarkets*. Retrieved online August 10, 2010, available at: http://thinkmarkets.wordpress.com/2010/06/17/jeffrey-sachs-and-the-keynesian-conundrum/

Rizzo, Mario (2010c). Never let a crisis go to waste. *ThinkMarkets*. Retrieved online August 10, 2010, available at: http://thinkmarkets.wordpress.com/2010/08/10/%e2%80%9cnever-let-a-crisis-go-to-waste%e2%80%9d/

Rizzo, Mario (2010d, March 8). Functional finance fantasy. *ThinkMarkets*. Retrieved online August 10, 2010, available at: http://thinkmarkets.wordpress.com/2010/03/08/functional-finance-fantasy/

Rizzo, Mario (2010e, September 18). *ThinkMarkets.* Retrieved online September 18, 2010, available at: http://thinkmarkets.wordpress.com/2010/09/18/the-second-austrian-moment/

Roberts, Russell (2010, April 28). Gambling with every peoples' money: How perverted incentives caused the financial crisis. *The Mercatus Center*.

Romer, Christina (2009a, August 6). So, is it working? An assessment of the American Recovery and Reinvestment Act at the five-month mark. Speech at the The Economic Club of Washington D.C. Retrieved online August 11, 2010, available at: http://www.whitehouse.gov/assets/documents/DCEconClub.pdf

Romer, Christina (2009b, March 9). Lessons from the Great Depression for economic recovery in 2009. Speech presented to the Brookings Institution, Washington D.C. Retrieved online August 6, 2010, available at: http://www.brookings.edu/~/media/Files/events/2009/0309_lessons/0309_lessons_romer.pdf

Samuelson, Paul A. (1988, July/August). In the beginning. *Challenge.*

Samuelson, Paul A. (1955). *Economics,* 3rd Edition. New York, NY: McGraw-Hill.

Sargent, Thomas J. (1979). *Macroeconomic Theory.* New York, NY: Academic Press.

Selgin, George and Lawrence H. White (1994). How would the invisible hand handle money? *Journal of Economic Literature* XXXII(4): 1718-1749.

Shackle, G.L.S. (1973). Keynes and today's establishment in economic theory: A view. *Journal of Economic Literature* 11(2): 516-519

Shlaes, Amity (2010, July 13). FDR, Obama and 'confidence.' *The Wall Street Journal*. Retrieved online August 10, 2010, available at: http://online.wsj.com/article/NA_WSJ_PUB:SB10001424052748703636404575353431153327248.html

Schram, Alan. (2009). Stimulus plans don't work. *Huffington Post*. Retrieved online August 12, 2010, available at: http://www.huffingtonpost.com/alan-schram/stimulus-plans-dont-work_b_159294.html

Skidelsky, Robert, Marcus Miller, David Blanchflower, Kern Alexander, Martyn Andrews, David Bell, William Brown, Mustafa Caglayan, Victoria Chick, Christopher Cramer, Paul De Grauwe, Brad DeLong, Marina Della Giusta, Andy Dickerson, John Driffill, Ciaran Driver, Sheila Dow, Chris Edwards, Peter Elias, Bob Elliot, Jean-Paul Fitoussi, Giuseppe Fontana, Richard Freeman, Francis Green, G.C. Harcourt, Peter Hammond, Mark Hayes, David Held, Jerome de Henau, Susan Himmelweit, Geoffrey Hodgson, Jane Humphries, Grazia Ietto-Gillies, George Irvin, Geraint Johnes, Mary Kaldor, Alan Kirman, Dennis Leech, Robert MacCulloch, Stephen Machin, George Magnus, Alan Manning, Ron Martin, Simon Mohun, Phil Murphy, Robin Naylor, Alberto Paloni, Rick van der Ploeg, Lord Peston, Robert Rowthorn, Malcolm Sawyer, Richard Smith, Frances

Stewart, Joseph Stiglitz, Andrew Trigg, John Van Reenen, Roberto Veneziani and John Weeks (2010, February 18). *The Sunday Times*. Retrieved online August 11, 2010, available at: http://www.skidelskyr.com/site/article/letter-to-the-financial-times-first-priority-must-be-to-restore-robust-grow/

Skidelski, Robert (2009). *Keynes: The Return of the Master*. New York, NY: PublicAffairs.

Smith, Adam (1981[1776]). *An Inquiry into the Nature and the Cause of The Wealth of Nations*, Volume II. Indianapolis, Indiana: Liberty Fund Inc.

Smith, Vernon L. (2007, December 18). The Clinton housing bubble. *The Wall Street Journal*. Retrieved online July 14, 2010, available at: http://online.wsj.com/article/SB119794091743935595.html

Summers, Lawrence (2010, May 25). Larry Summers, Obama's top economic adviser, makes the case for another round of stimulus spending. The Huffington Post. Retrieved online July 14, 2010, available at: http://www.huffingtonpost.com/2010/05/25/larry-summers-obamas-top_n_588787.html

Summers, Lawrence (2008, December 28). Obama's down payment: A stimulus must aim for long-term results. *The Washington Post*. Retrieved online July 7, 2010, available at: http://www.washingtonpost.com/wpdyn/content/article/2008/12/26/AR2008122601299.html

Taylor, John B. (2009). *Getting off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis*. Stanford,CA: Hoover Institute.

The economy: We are all Keynesians now. (1965, Friday, December 31). *Time* magazine. Retrieved online August 6, 2010, available at: http://www.time.com/time/magazine/article/0,9171,842353-1,00.html

Wolf, Martin (2010, June 16). Why plans for early fiscal tightening carry global risks. *Financial Times*. Retrieved online August 11, 2010, available at: http://www.ft.com/cms/s/fc8d1dd4-78b6-11df-a312-00144feabdc0,Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2Ffc8d1dd4-78b6-11df-a312-00144feabdc0.html&_i_referer=

White, Lawrence (2009). A brief history of credit rating agencies: How financial regulation entrenched this industry's role in the subprime mortgage debacle of 2007 – 2008. *Mercatus on Policy*, October (59).

Wright, David McCord. (1958, November 21). Mr. Keynes and the “day of judgement.” *Science:* 1258-1262.