LSE Department of Economics
In advance of Visit Day, Thursday 18 April 2013

This ‘flipped lecture’ recorded 15 April

‘ “Fear the Boom and Bust”:
The Economics Behind the Keynes-Hayek YouTube Rap’

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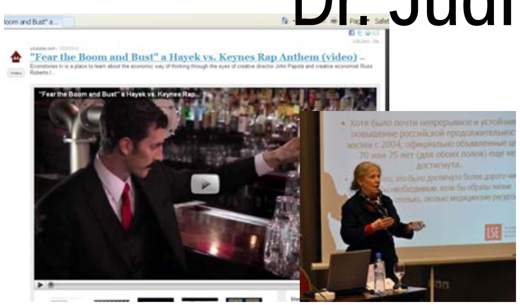
On Visit Day Itself:

Discussion: 2 -2.45 pm NABLG08

Reception: Old 3.21 [Shaw Library]

Presented by:
Dr. Judith Shapiro, Undergraduate Tutor
(j.c.shapiro@lse.ac.uk)



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Boom and Bust" a...

Page Safet

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44

Votes

youtube.com - 1/25/2010

"Fear the Boom and Bust" a Hayek vs. Keynes Rap Anthem (video) –

Econstories.tv is a place to learn about the economic way of thinking through the eyes of creative director John Papola and creative economist Russ Roberts.I...

Share on:

- YouTube: http://www.youtube.com/watch?v=d0nERTFo-Sk
    - Total Views: **4,193,075 (this morning)**
- Today we will watch:
  Video with lyrics: http://dotsub.com/view/63fa17f9-51e9-4339-bd5e-501f7703676d
- Lyrics, story and download of the song in high quality MP3 and AAC files at www.econstories.tv
- There too: 2 more in the series, video documentaries.
- Makes the back story clear: this is an extremely professional (and fairly presented) support for the ‘Austrian’ view of what to do.

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Opening and Chorus

We've been going back and forth for a century

[Keynes] I want to steer markets,

[Hayek] I want them set free

There's a boom and bust cycle and good reason to fear it

[Hayek] Blame low interest rates.

[Keynes] No… it's the animal spirits

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Lyrics: Spot the accidental omission?

Keynes:

- ‘John Maynard Keynes, wrote the book on modern macro
  The man you need when the economy’s off track, [whoa]
  Depression, recession now your question’s in session
  Have a seat and I’ll school you in one simple lesson

- BOOM, 1929 the big crash
  We didn’t bounce back—economy’s in the trash
  Persistent unemployment, the result of sticky wages
  Waiting for recovery? Seriously? That’s outrageous!

- I had a real plan any fool can understand
  The advice, real simple—boost aggregate demand!
  C, I, G, all together gets to Y
  Make sure the total’s growing, watch the economy fly’

And Hayek rebuts:

- So the boom turns to bust as the interest rates rise
  With the costs of production, price signals were lies
  The boom was a binge that's a matter of fact
  Now its devalued capital that makes up the slack.

- Whether it's the late twenties or two thousand and five
  Booming bad investments, seems like they'd thrive
  You must save to invest, don't use the printing press
  Or a bust will surely follow, an economy depressed

- Your so-called "stimulus" will make things even worse
  It's just more of the same, more incentives perversed
  And that credit crunch ain't a liquidity trap
  Just a broke banking system, I'm done, that's a wrap

Focus here on the key *economics* in dispute
Political and historical studies well worth it too

- Keynes:

  I had a real plan any fool can understand

  The advice, real simple—boost aggregate demand!

  C, I, G, all together gets to Y

- Hayek:

  Your so-called "stimulus" will make things even worse

  It's just more of the same, more incentives perversed

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At the core of the Keynesian case: The multiplier

Greg Mankiw, Harvard, in the New York Times

[His macro text used in EC102]

“Economics textbooks, including Mr Samuelson’s and my own more recent contribution teach that each dollar of government spending can increase the gross domestic product by more than a dollar….”

Actually by much more, *if* multiplier really = 1/(1-MPC)

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But…..

- Mankiw adds "In practice the multiplier of government spending is not very large"
- Cited Valerie Ramey, arguing that (sophisticated econometric) work found most components of US personal consumption fell after a "shock" rise in government spending. Thus fiscal multipliers actually are seen as between .4 and 1.1!
  - http://econ.ucsd.edu/~vramey/research/IdentifyingGovt.pdf

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First a small correction in the anthem: C+I+G ?= Y

Consumption + Investment +Government Spending = Income

- What's missing?
- This would be for a closed economy. No foreign trade
- C+I+G+X-M =Y in an open economy

  X = Exports and M = Imports

Now what happens in the textbook if there is a "shock", an unexpected increase in government spending

Let's suppose the multiplier is 1.5…..

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The argument against, Hayek's case:

- G may rise, but this may also result in other parts of C+I+G+X-M falling, perhaps even more
- This is"crowding out": G crowds out private consumption and/or investment, M grows
- Investors may well panic about fiscal fragility
- Exchange rate if flexible reacts
- If large ΔG (spending way up) "Ricardian equivalence", increased saving in anticipation of higher taxes down the road (that is later)

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- The economics profession did not and does not agree on one question that is critical in the evaluating governments' responses to the crisis:
- How large is the stimulus impact of fiscal spending?
- In a January 2009 *Wall Street Journal* op-ed piece, Robert Barro argued that peacetime fiscal multipliers are essentially zero.
- Christina Romer (2009), Chair of President Obama's Council of Economic Advisers, used multipliers as high as 1.6 in estimating the job gains generated by the $787 billion stimulus package approved by Congress in February. What did she say later? …In reading.
- The difference between Romer's and Barro's views of the world amounts to a staggering 3.7 million jobs by the end of 2010. What did Romer conclude?

Top googles for “fiscal multiplier”
(after Wikipedia)

- http://www.voxeu.org/index.php?q=node/4036

Dr Ethan Iltzetki (LSE), Mendoza and Vegh

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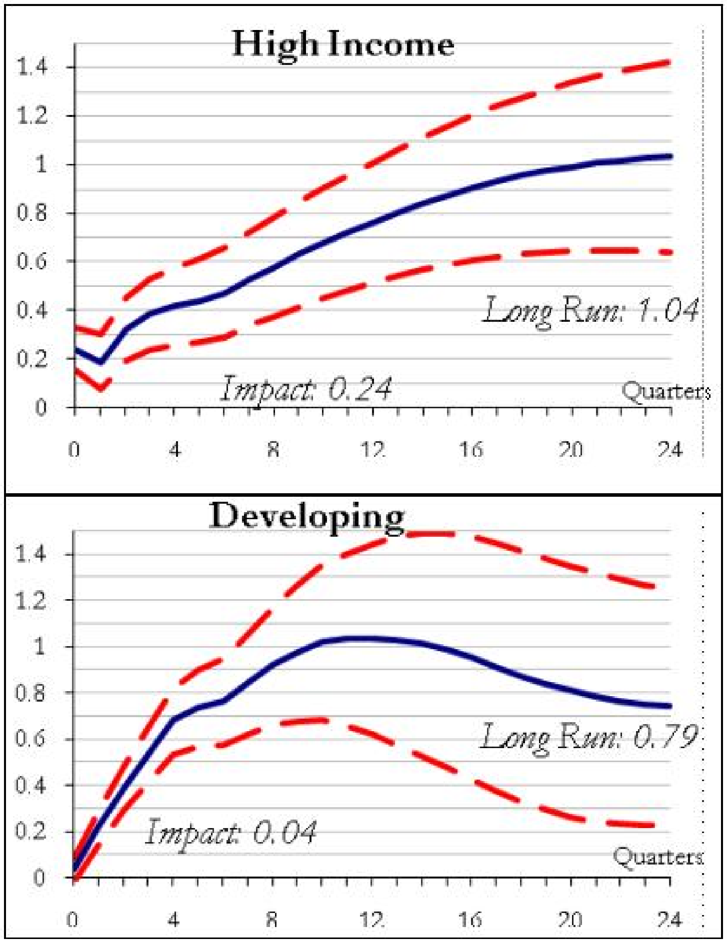
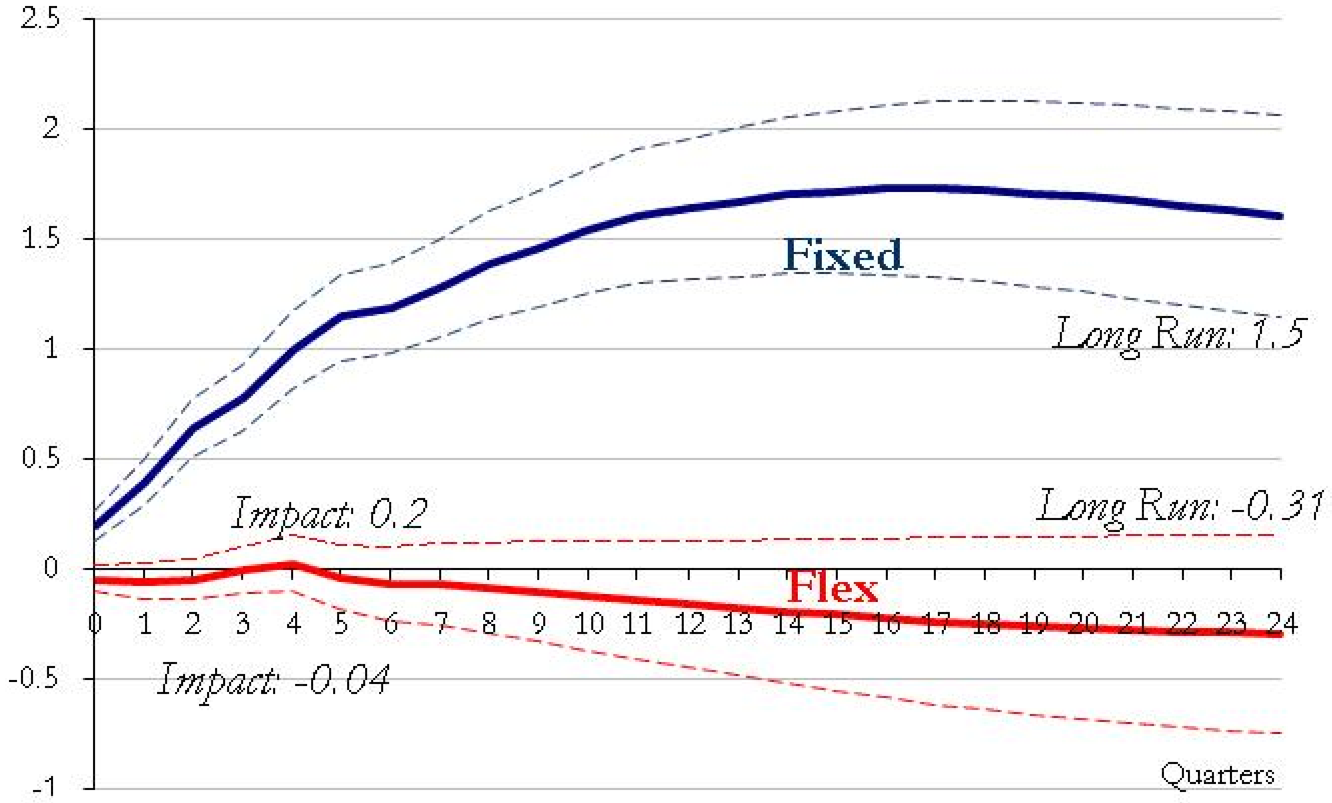
How big are fiscal multipliers?
New evidence from new data



http://www.voxeu.org/index.php?q=node/4036

Iltzetzki, Mendoza and Vegh as before

Exchange rate regimes matter



Source: as previous slide

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Hayek was opposed not just to a fiscal stimulus, but *also* would not have favoured Chicago School policies

- The rap metaphor: drunk on debt and have a hangover,? Do *not* have "a hair of the dog that bit you"!
- Later, Milton Friedman and the Chicago School saw it differently later: Hayek and Robbins offered nothing at a time of crisis, when deflation was a real threat.
- Robbins later agreed with Friedman that he was wrong to support Hayek: In the Keynesian moment of 1931-1933 fiscal stimulus not crowding out – nothing to crowd out
- Krugman argues Hayek not the real anti-Keynes
- Excavation of a "battle of letters" like 2010 in 1932: *not exactly Cambridge vs LSE either. LSE on both sides.*

So multipliers not the big numbers of the textbook? Even for a non-Keynesian can be a useful concept:

1998: Russian default and devaluation

Multiplier useful to work out likely knock-on effects: UN/ECE: *Economic Survey of Europe*, 1998 No 2

- Lithuanian pre-crisis half-year exports about 20% of GDP
  - Of these about 45% to CIS (Russia, Ukraine, Belarus…)
  - So roughly 9% of Lithuanian GDP exports to CIS
  - What is a plausible multiplier? 1.4? 1.8?
  - What else (eg lower T, higher G? could brake the fall?
  - Lithuanian GDP went from 7.4% up in 1998 to -2.4% in 1999
- Example 2: Regional multiplier for lumber road in Redwood City

For Thursday: “join the debate”

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