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KEYNES AND HAYEK'S APPROACHES TO COMBATING ECONOMIC CRISES WITH A COMPARATIVE ANALYSIS

KARŞILAŞTIRMALI BİR ANALİZLE KEYNES VE HAYEK'İN EKONOMİK KRİZLERLE MÜCADELE YAKLAŞIMLARI

ABSTRACT

When viewed from a macroeconomic perspective, different theories in economics, as in all sciences, seek to find the best method and solution that will positively affect the welfare of the society and the individual with different approaches. In particular, the uninterrupted, balanced provision of scarce resources to the service of people and the optimal management of this in an economical way stands out as the primary goal of economists and managers. However, the issue of which method and policy will provide optimal benefit has been discussed throughout history and no consensus has been reached. In this context, Keynes and Hayek come to the fore as two important scientists who are at the center of this discussion. Keynes and Hayek guided the society with their theories and approaches, which are still valid today, as they did in their lifetime, contributed to the right decision-making of economic administrations, and most importantly, contributed to the development of economics. In this respect, this study aims to contribute to the understanding of economic policies by presenting a comparative analysis.

Keywords: Keynes, Hayek, Crisis, Monetary policy, Fiscal Policy, Expenditures, Economic Balance
Jel Code: E, N, P, A11.

ÖZET

Makroekonomik bir çerçevede bakıldığında tüm bilimlerde olduğu gibi ekonomide de farklı teoriler farklı yaklaşımlarla toplumun ve bireyin refahını olumlu yönde etkileyecek en iyi yöntemi ve çözümü bulma arayışındadır. Özellikle kıt kaynakların kesintisiz olarak dengeli bir şekilde insanların hizmetine sunulması ve bunun ekonomik olarak optimal bir şekilde idaresi ekonomistlerin ve yöneticilerin birincil hedefi olarak ön plana çıkmaktadır. Ancak hangi yöntem ve politikanın optimal fayda sağlayacağı konusu tarih boyunca hep tartışılmış ve hemfikir sağlanamamıştır. İşte bu çerçevede bakıldığında Keynes ve Hayek bu tartışmanın odağında olan iki önemli bilim insanı olarak ön plana çıkmaktadır. Keynes ve Hayek yaşadıkları dönemde olduğu gibi günümüzde de hala geçerliliğini koruyan teorileri ve yaklaşımlarıyla topluma yön vermiş, ekonomi yönetimlerinin doğru karar almalarına katkı sunmuş ve en önemlisi ekonomi biliminin gelişmesine katkı sunmuştur. Bu açıdan bu çalışmanın iktisat politikalarının anlaşılmasına karşılaştırmalı bir analiz sunarak katkı sağlamayı amaçlamaktadır.

Anahtar Kelimeler: Keynes, Hayek, Kriz, Para politikası, Maliye Politikası, Harcamalar, Ekonomik Denge
Jel Kodu: E, N, P, A11.

1. PROLOGUE

Managing economic activities and balancing income-expenditure are among the most emphasized issues of society throughout history. In this respect, scholars have offered various suggestions developed theories in this field. On the other hand, especially in the period of economic crises, approaches with different methods and results come to the fore regarding the role of the government and the economic policy to be followed. When the subject is considered in this context, Keynes and Hayek are at the forefront of the approaches that contradict each other but inspire each other as well.

More importantly, different concepts, or rather opposite thoughts, on economic issues usually come to the fore in terms of the methods to be applied in times of crisis. Especially in 1929, the great depression, which affected the whole world, especially the USA, has been a test in which economic theories. Classical economic theories could not adequately support the governments seeking a way out of this crisis. However, Keynesian approaches from this crisis have been the most effective option to overcoming the crisis.

As a matter of fact, as a result of Keynes' prescriptions coming out of this crisis, Keynesian economics continues to be effective from World War II to the present day. As a matter of fact, the role of the state in every stage of the economy has been inevitable in the COVID 19 pandemic. On the other hand, Hayek's approaches have been intensified since the crisis in the 1970s, although not as much as Keynes. Today, Keynesian and Hayekian approaches defend their own positions and these approaches are the subject of economics education. In this study, these debates have been scrutinized with a comparative analysis, especially within the framework of Keynes and Hayek's theories.

2. THEORETICAL and CONCEPTUAL FRAMEWORK

Anyone interested in economics, without exception, encounters the theory of John M. Keynes. On the other hand, Hayek's thoughts, although not as much as Keynes's, are among the most discussed topics, especially among economic scientists. On the other hand, Keynes and Hayek, on the one hand, are at opposite poles with the economic policies they advocate and the solution proposals they propose, on the other hand, they have approaches that complement each other. In this respect, in this study, this subject is focused on the comparative analysis method. In a comparative analysis, two or more ideas are examined and then compared with each other. As a rule, distinctive or similar features of the researched topics can be specified or recognized. Research questions of the study are:

- What aspects of Keynes and Hayek's economic policies are similar and different?
- Which approaches are more applicable in dealing with economic crises? Why?

3. KEYNES APPROACHES IN COMPARISON

Keynes in General Theory, criticized in detail the view developed by J.B. Say, also known as Say's law, that every supply will create its own demand and therefore no excess supply can arise in free market economies. The Classical Theory asserts that the production processes in a free-market economy will progress with their own internal dynamics, that these processes will not be interrupted, and that even if there are problems, the system has internal mechanisms to solve these problems. In this approach, it is unnecessary for the state to intervene in the exchange processes. According to A. Smith, the realization of economic activities in such a way that resources are used in the most appropriate way takes place with the price mechanism. In Smith's system, the determination of flexible prices in the market provides the necessary and sufficient conditions for the parties to maximize their benefits in the exchange. If the prices that enable the exchange to take place are determined in the market without any outside intervention, equilibrium is always achieved at the full employment level in a free market economy. In the study titled A Treatise on Political Economy, written by Say in 1803, it is argued that although prices are not flexible, full employment balance will be achieved by itself. The law, which is named after Say, states that, under the assumption that money only has the function of a medium of exchange, the total factor incomes are always equal to the total output expenditures, since the expenditure of one party constitutes the income of the other party in the exchange (Ardıç & Aydın, 2013). In both Smith's and Say's approaches, it is assumed that the economic individuals who exchange are behaving rationally. Rationality, on the other hand, is possible only by having the necessary information for exchange. This information also covers the future period. In other words, there is no uncertainty about the future.

It can be said that one of the most important concepts developed by Keynes is 'effective demand'. Effective demand, which plays a dominant role in the Keynesian approach, is an analysis, which instabilities that arise in the production processes are explained by the investment decisions of the entrepreneurs. Keynes defines effective demand as the sum of consumption and investment goods that are expected to be sold, i.e. demanded, by entrepreneurs at the current employment level. According to Keynes, the future is uncertain in the world we live in and it is impossible to accurately predict future events. Therefore, investment decisions mainly depend on the external expectations of entrepreneurs or, as Keynes puts it, on their animal instincts (Davidson, 2001). Uncertainty gives rise to expectations that are influenced by emotions, intuition, routines, and animal instincts (animal spirits). Moreover, economic instabilities can be endogenous, unlike the market model, which is assumed to be stable and only exogenous shocks lead to disequilibrium. Keynes's concept of uncertainty mostly covers investment decisions for which probabilistic calculations for the future cannot be made.

Two important propositions can be mentioned in the General Theory: First, the full employment equilibrium advocated in the Classical-Neoclassical theory is a special case; secondly, the 'economic man' of Neoclassical theory, isolated from the social environment involved in microeconomic analysis, maximizing his self-interest, cannot be generalized, that is, must be regarded as a special case. In the neoclassical approach, while the problem of maximization and rational choice is handled in an axiomatic world under the assumption of complete knowledge, Keynes takes into account the 'real world we live in'. Consumers have a certain propensity to consume and this tendency is determined exogenously. In other words, the behavior of consumers is considered stable. Entrepreneurs' production decisions depend on expected demand. In a non-static situation, there are sequential decision-making processes. Instability is possible; because all decisions are future-oriented and expectation-based. This does not allow well-calculated optimization processes. Decisions are made under conditions of incomplete information, and there may only be limited maximization (Schettkat, 2018a: 5). Decisions about the future and determined according to expectations cannot be made under stochastic processes that allow perfect foresight. In Keynes' approach, economic actors are not homo economicus isolated from the social environment in which they live; on the contrary, they are individuals who have relative positions according to their environment and experiences. While discussing what kind of behavior individuals have, an economy in which money is used for savings and speculation is taken into account, not an economy in which money acts as a veil in the exchange process (Schettkat, 2018b).

In Keynes' system, the economy is not governed solely by rational actors who, with the help of the 'invisible hand', ensure that exchange transactions always take place for the benefit of both parties. According to Keynes, most economic activities are the result of rational economic motivation. But people can have non-economic motivations; that is, the economic activities of people are not always rational. The presence of uncertainty gives rise to decision-making processes governed by 'animal spirits'. In the model developed by Keynes, animal instincts can be seen as the main reason for business cycle fluctuations. Similarly, the emergence of involuntary unemployment can be explained by the same concept. Focusing on the main factor that plays a role in the decision-making processes of entrepreneurs, Keynes emphasizes animal instincts while explaining why equilibrium does not occur at the full employment level in an economy. Chapter 12, entitled Long-Term Prospects in General Theory, states that our knowledge is too poor or sometimes nothing at all to make long-term estimates of the return on investment in railroads, mining, textile mills, or construction in London. the result of animal spirits; it is stated that it may be a result of spontaneous impulses (Spontaneous urge) (Keynes, 2013: 147-164).

As stated above, the subject of uncertainty is more related to investment decisions since it is related to the long-term future. In Keynes' model, the investment decision depends on the marginal return on capital determined by the expected income and expenses in the future period. Therefore, whether or not they have confidence in the future is the most important factor affecting the expectations of investors. At this point, Post Keynesian economists point out that Keynes makes a distinction between 'logical time' and 'historical time'. According to the orthodox equilibrium theory, the difference between yesterday, today and tomorrow is logical, not historical. However, according to the Post-Keynesian approach, the separation of logical and historical time is of fundamental importance for the formation of expectations (Hermann and Klaus-Dieter, 1988: 27).

Keynes often uses terms like 'the world we live in' or 'real world' to emphasize the difference of his model from Classical-neoclassical theory. According to Keynes, the assumptions of a theory should not contradict reality. In this context, the main features of the developed model can be listed as follows:

- Expectations are future-based (zukunftsgerichtet) and are created in conditions of incomplete information where uncertainty is involved.
- In the real world, we live in, decisions are not made by a fictitious economic agent trying to maximize a given function, as in the Neoclassical model. On the contrary, emotions, traditions, norms, habits, intuitions (Heuristics), animal instincts play an important role in decision-making processes.
- The realization or non-realization of expectations is internal within the framework of the market mechanism.
- The deduction applies instead of deduction: the real economy we live in
- Humans are taken into account instead of homo economicus
- A dynamic economy, not a stagnant one

Since uncertainty conditions are valid instead of calculable risk in an incomplete information environment, rational expectations hypothesis cannot be valid in decision-making processes for the future. In the past and present, economic theory has largely been limited to analyzes based on the assumption that the risks of expected values for the future are calculable and therefore optimizable. In this approach, it is assumed that the probability distribution can be calculated, although the future values of the relevant variables are not known. However, uncertainty, which plays a dominant role in the system developed by Keynes, refers to situations where the probability distribution of the variables is not known and cannot be known. In other words, it is not possible for us to know the long-term developments in price and interest rates (Schettkat, 2018b: 8-9).

It can be said that the most important concept developed in the General Theory is the concept of "effective demand". Pointing out that high wages are not the cause of the economic crisis, unlike classical economists, Keynes argues that lowering real wages is not a solution and that this situation will further increase instability. The main cause of the crisis is insufficient demand and the solution is to expand the effective demand. Effective demand is defined as the sum of consumption and investment goods that are expected to be demanded, that is, expected to be sold by entrepreneurs at the current employment level. Accordingly, effective demand is an expectation size (Paya, 2001: 211). In Keynes' analysis, in a monetary economy, the monetary funds of the savers are money, bonds, etc. Holding them as financial assets provides the necessary and sufficient condition for the existence of involuntary unemployment. Effective demand is insufficient in such an economy, which means that the saved funds are not used for investment expenditure. Insufficient effective demand causes involuntary unemployment and the economy to operate below the full employment level (Tanyeri, 1998: 30). Given the consumption trend, expectations have an important place in determining the investment volume, which is the main determinant of effective demand. The volume of investment depends on the interest rate on the one hand and the marginal efficiency of capital on the other. Since these two variables are directly under the influence of uncertainty, investment expenditures fluctuate significantly. In this context, the effective demand for full employment in the economy can only be realized by chance. More importantly, even if the effective demand that provides full employment is realized, the system will not be able to maintain the full employment level (Yeldan, 2006).

4. KEYNES VS HAYEK

When John Maynard Keynes and Friedrich August von Hayek are compared on their economic policies, it is seen that they have quite different points of view. The basis of this is that the two evaluate the functioning of the markets and the role of economic agents in different ways. Indeed, while Keynes advocates strong government intervention in markets when necessary, von Hayek argues that laissez-faire capitalism can balance within its own dynamics.

Despite these different views of Keynes and von Hayek, the data they used and the events they inspired in terms of confronting the problems of the same period were experienced in the same period. What makes them different is that they have different approaches to these events and problems and the solutions they propose are different. Both economists were among the intellectual scientists of the period who had to face the consequences of the 1929 depression that followed as they witnessed the First World War. Although these two scientists have experienced the economic crises that have affected the world from beginning to end, their solution proposals have always been guiding according to their place and time (Rothbard, 2000:11).

Unlike von Hayek, Keynes defends the thesis that markets cannot automatically provide full employment and that there may be long-term large-scale unemployment during downturns. Keynes emphasizes that it is the government's duty to alleviate the situation of the unemployed by increasing the aggregate demand for goods and services and highlights public expenditures (G).

J.M. “We don't do anything because we don't have money,” Keynes told a government committee investigating the causes of the economic crisis in 1930. In the most striking way, he expressed the state's intervention in the crisis through public expenditures (G) so that the economic revival could take place. On the other hand, in response to Keynes's interventionist approach, von Hayek clearly and clearly criticized public intervention as it would increase expenditures and cause inflation. According to von Hayek, any policy that will increase inflation with the hope of reducing unemployment and bringing vitality to the market will result in further deterioration of economic balances, and most importantly, the inefficiency of the market economy and a longer-term deterioration in economic performance (Yılmaz & Keskin, 2018:7).

However, both Hayek and Keynes did not adopt a radical attitude despite their different opinions. Indeed, Keynes advocated state intervention in the economy only to the limited extent necessary. Keynes did not advocate socialism, but he supported the welfare state and public intervention policies. Although Hayek also advocated liberalism, he avoided a purely capitalist approach. According to Hayek, in the case of chronic unemployment, planning can play a role without causing pressure (Hayek, 2007).

Keynes, in his work titled "The General Theory of Employment, Interest and Money", which deals with classical economics and economists such as Hayek in 1936, stated clearly why the intervention of the state in the market can sometimes be inevitable and how it can happen, in the context of exit from the economic crisis. broke new ground. Keynes' ideas still form the cornerstone of crisis exit policies. As a matter of fact, during the COVID 19 pandemic process, all countries have had to implement economic policies that emphasize the public intervention based on Keynes, although in different dimensions.

Keynes' economic policies are based on the thesis that employment levels are determined by the price of labor, supply creates its own demand, and savings automatically turn into an investment. Thus, Keynes was not advocating opposition to a free market economy. On the contrary, he defended this system, but he argued that in every system, crises will occur from time to time depending on the conjuncture and that the state should intervene in the market with policies that will improve the economy in a temporary period for the solution of this.

Hayek, on the other hand, mostly expressed the wrongness of the social state policies followed after the second world war. Hayek, in his book “The Road to Serfdom” warns of the potential dangers of centralized economic planning, highlighting that the market economy is the best solution to avoid the formation of totalitarian regimes. The ideas advocated by economists such as Milton Friedman, who argued that Hayek's main tool for managing the economy is monetary policy, not fiscal policy, became stronger especially with the collapse of communist regimes. The same view has been strongly defended by economists such as Alan Greenspan (Özel, 1990). Therefore, in this period, the world economy took a break from Keynesian ideas for a long time and focused on liberal ideas such as Hayek and Mises. However, recurrent crises from time to time resulted in the application of Keynesian theory. Friedrich Hayek argues against the idea that it is possible to spend the way out of an economic collapse, as Keynes advocated. However, according to Hayek's approach, he does not advocate the idea that economic balance can be achieved by doing nothing in a crisis. Hayek is more important in getting out of the crisis and rallying not only to spend enough but also to return to sustainable production. Thus, the production and economic growth that it requires are freed from the boom period distortions caused by easy money. According to Hayek, the crisis can be resolved, especially through monetary policy, to get out of the crisis. But Hayek, exiting an unsustainable crisis comes at a cost. Keynes called this the "underemployment equilibrium". This was because the level of activity depended on the level of output and employment in aggregate demand or spending power. According to Keynes, if the overall spending power in an economy decreases, the level of output decreases. In this case, it is among the main duties of the state to increase public expenditures in order to balance the decrease in public expenditures, that is, to provide a deficit to the required extent. On the other hand, according to Hayek, the main reason for the collapses is the excessive credit creation of the banks leading to excessive spending (Wapshott, 2011: 22-23).

From an economic perspective, policymakers may choose to intervene in the economy with Keynesian policy or self-balancing the market with the Hayek approach in times of crisis. Hayek basically bases his theory on Say's "laissez-faire" approach and Smith's "invisible hand" perspective. On the other hand, in the global market dominated by liberalism, it is a generally accepted fact that governments spend to support demand in times of crisis and that the state is actively involved in the market economy. Especially in developing and underdeveloped countries, a mixed policy is actually being followed against the crisis. More importantly, Hayek's leave the economy alone approach has not been accepted as viable since the 1929 depression. Keynes' recipe for getting out of the great depression has been widely applied by experiencing changes and transformations. Organizations such as the IMF suggest tight or loose monetary and fiscal policies, when necessary, by blending both Keynes and Hayek policies (Hayek, 2007:28).

While Keynes advocates mass government intervention in the economy to bring the economy out of recession, Hayek recommends that during a recession the market should do nothing but balance the market itself. One of the economists Hayek was inspired by was Carl Menger, one of the representatives of the Austrian school. Menger is one of the important scientists who shaped economic theory with his marginal utility and auction approaches. According to Menger, the price of a good or service is shaped by the need for it in the market (Alpago, 2018). In other words, just like in the stock market, the price of goods and services is in a constant change and balancing process according to the supply and demand situation they face. In times of crisis, the Austrian approach advocates austerity. This means coping with the crisis on their own terms. However, Keynesians advocate injecting money into the economy to stimulate spending. When Keynes and Hayek are compared, the common goal of both is the development of economic policies that will increase the welfare of society. In other words, Keynes is not a statist, and Hayek is not a capitalist. Both actually base their thoughts on Smith's "scarce resources and infinite needs" approach. Only the method they follow and the solution they propose differ. On the other hand, Keynes' approach seems more realistic and applicable. Because the intervention of the state at the time of crisis is a necessity and result of public understanding. Just as with the COVID 19 pandemic, sometimes exiting a crisis without public intervention can lead to far more costly and dire consequences. The pandemic experience has once again brought Keynes's thoughts to the fore in this respect (Smith, 1990).

On the other hand, while Hayek was inspired by economists such as Carl Menger and especially Ludwig von Mises in the Austrian school, Keynes developed a unique school by blending the ideas of economists such as Ricardo and Marx with liberal ideas such as Smith and Say. The methodological positions of Hayek and Keynes contain striking similarities. Both authors opposed empiricist approaches to economics that prioritized pure observation as the source of knowledge. Both emphasized purposefulness, motivation, and the human factor. For example, Carl Menger, like Hayek, focuses on spontaneous observations and facts rather than empirical models. As a journalist, Menger argued that what he saw and experienced in the field was more important than what was taught in theory. Likewise, Keynes should let the government regulate the market and straighten it out instead of doing what the free-market theorists have said during the crisis, and then not prevent the continuation of free market rules (Bayraktar, 2012: 259).

John Maynard Keynes and Friedrich August von Hayek were pioneers of the early twentieth century. They developed the economic theory that would shape polarizing parts of economic belief. Keynes considered it necessary for the government to play an important role in reducing unemployment. To him, deficit spending was the only way to get the economy out of a depression and to a higher point of employment. But Hayek saw it differently. He criticized Keynes' belief in monetary policy that drives interest rates down through an increased money supply. Hayek argued that because interest rates would be artificially low, this strategy would increase inflation and ultimately lead to "bad investments." Keynesian economics assumes that the economy is a fragile thing that requires constant fine-tuning by the State. This automatically assumes that entrepreneurship is driven by the State. As in the Gaia theory, Hayek assumes that the economy is a living, breathing, feeling entity that can find its own way through the judgments and decisions of the millions of entrepreneurs who make them. Just like millions of cells in a human body. Von Hayek argues that Government intervention distorts the investment decisions of individual investors, thus forcing them to make bad decisions. However, leaving the economy to its fate during the crisis is not a solution and may lead to a deepening of the crisis. In this respect, Keynes' approach can be considered more accurate. As a matter of fact, the Keynes approach in the 1929 crisis shows an effective application example for exiting the crisis (Keynes, 1936: 33-39).

5. CONCLUSION

Although John M. Keynes and Frederick Hayek, who directed the economic policies, had different views, they believed in the dynamics of the economy and advocated different solution methods in order to realize this potential and overcome the crises it faced. As the common point of the two, they believed in the market economy and thus advocated the use of scarce resources with maximum efficiency. However, Keynes argued that this process may be interrupted in time due to the crises and that the state should intervene in the economy temporarily and restore the balance in order to make it functional again and get out of the crisis. Hayek, on the other hand, argued that the market dynamics have the capacity and power to solve the crises in their own way, and found it unnecessary for the state to intervene in this process, and argued that such an intervention is against the spirit of the free market economy.

Keynes actually took an equivalent approach to Hayek's theory, saying that market agents have animal instincts, a natural balancing act, and the ability to make the best decision. However, this approach of Keynes does not mean that everything is fully processed in a free-market economy and the results are always in balance. On the contrary, Keynes considered intervention as a public duty, accepting that there would be deviations from time to time, just as an economic system can be experienced in a clockwork mechanism.

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