Arie Arnon

Debates in Macroeconomics from the Great Depression to the Long Recession

Cycles, Crises and Policy Responses

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To Ruth my beloved partner in life for over almost half a century,
To Inbal, our daughter, to Adam our son,
To Alma, Noam and Daniel, our grandchildren,
Who bring much joy and love to our lives.
Wishing and hoping for your wonderful future.

Praise for *Debates in Macroeconomics from the Great Depression to the Long Recession*

"When the 2008 crisis struck, macroeconomists were caught with models that were theoretically elegant yet inappropriate to the needs of the moment. A broader historical perspective may have prevented the jettisoning of Keynesian models that had proved useful in the past and might have done so again. This highly readable book by Arie Arnon is a wonderful antidote to economists' short time horizon and contributes mightily to restore the profession's "collective memory" of the diversity of ideas within macroeconomics."

—Prof. Dani Rodrik, *Harvard Kennedy School*

"All too often over the last century, macroeconomic ideas (not always the same ones) have been successfully marketed and then adopted as elixirs of general prosperity. Nowadays, their consumers are demanding that they be bottled with warning labels. This thoughtful and learned book offers a fascinating and sometimes-provocative account of how all this came about. It should be read by anyone who is troubled by the current state of the sub-discipline."

—David Laidler, *Professor Emeritus, University of Western Ontario*

"Arie Arnon has written an excellent description of the main macroeconomic debates in the 1930s, particularly the debate between those wanting more, or less, government intervention, Keynes versus Hayek. He goes on to show how Keynesian analysis gave way first to monetarism and then to the new classical macroeconomics. He criticises the new classical macroeconomics, primarily influenced by Lucas, on the grounds of excessive simplicity, undue reliance on 'representative agents', and incapacity for giving a satisfactory model treatment of crises, as in 2008 and now again with Covid. All this is very nicely set out, well written and easily accessible, but I would have liked more guidance on a better direction of travel for macroeconomics from here onwards."

—Charles Goodhart, CBE, FBA, *Professor Emeritus of Banking and Finance with the Financial Markets Group at the London School of Economics*

"This book tells the story of how macroeconomics gained momentum during the Great Depression and lost it during the Great Moderation, until the 2008 crisis forced economists to come to grip with the reality of the instability of the economic system as a whole. The arguments are presented with great clarity and a scholar background of the literature. A recommended reading for anyone concerned with the issues at stake in contemporary controversies in economics."

—Prof. Cristina Marcuzzo, *Sapienza, Università di Roma*

"Whether one agrees with his analysis and conclusions or not, Arnon's tome is a very important contribution to the literature on the historical interaction between economic theory and policy in the 20th and 21st centuries. Indeed, it may be said that he has done for the Great Recession what Haberler did for the Great Depression."

—Warren Young, *Professor Emeritus, Economics, Bar Ilan University*

"A reconsideration of the macroeconomics debates since the Great Depression is crucial both for building better macroeconomic analysis and for improving policy choices. Professor Arnon's book is very valuable in this respect, providing a brilliant, wide survey of the relevant literature with an interesting personal perspective."

—Prof. Alessandro Roncaglia, *Accademia dei Lincei and Sapienza, Università di Roma*

"In his new book, Debates in Macroeconomics from the Great Depression to the Long Recession, Arie Arnon, an eminent historian of classical monetary theory, has turned his attention to the history of macroeconomics over the past 90 years. His carefully researched, insightful and even-handed account of these debates will be read with profit by a wide audience seeking to understand how modern macroeconomics arrived at its current troubled state."

—Dr. David Glasner, *An Economist*

"Macroeconomics in the face of economic crises: from the innovations elicited by the Great Depression of the 1930s to the unpreparedness and doubts of recent years. An illuminating reconstruction of almost a century of conflicting theories and, above all, conflicting visions of how the market economy works."

—Prof. Annalisa Rosselli, *Accademia dei Lincei and University of Rome Tor Vergata, Italy*

"Arie Arnon's long career as a distinguished historian of economic thought has centered on the perennial controversies of monetary economics. In this book Arnon provides a sure-footed and deeply-informed review of the origins of macroeconomics in Keynes' General Theory and its fate at the hands of Hayek, Friedman, and the mathematics of the New Classical Macro movement. This is a sad scientific tale of a Great Forgetting, as the precious practical policy insights Keynes wrested from the Great Depression slipped into the obscurity of Dynamic Stochastic General Equilibrium orthodoxy. Those who forget the past, we are told, are condemned to repeat it."

—Prof. Duncan K. Foley, *Leo Model Professor of Economics, New School for Social Research*

"Arie Arnon has produced an important new book about the history of macroeconomics between the 1929 and the 2008 economic crises. This is a very challenging project, which Arnon carried out quite efficiently. The book sheds new light on key macroeconomic controversies, from Keynes vs Hayek to Friedman, New Classical Macroeconomics, New Keynesians and Post Keynesians. Such a comprehensive insightful account of the history of macroeconomics should not fail to attract the attention of historians of economics and macroeconomists alike."

—Mauro Boianovsky, *Universidade de Brasilia*

Preface: Macroeconomics Facing a Ghost—2008 and the Threat of a New Depression[1]

Debates in Macroeconomics from the Great Depression to the Long Recession reexamines some of the major schools in macroeconomics theory, focusing on their analysis of cycles, crises and the consequences they drew for macro policy. The book explores the rise of macroeconomics after the Great Depression and its significant paradigmatic transformation in the years leading to the Long Recession that started in 2008. Those years witnessed changing attitudes toward the fragility of the capitalist system and saw first the rise and then the decline of "active" macro policy. The greater the time span from the Great Depression, the more most macroeconomists tended to downplay the system's fragility and the threats of a second Great Depression. After all, "It"—the infamous specter haunting economics since the 1930s, that of another depression—has not happened again, though, as we all know by now, 2008 brought scary moments for the global financial system, transmitting threats which alarmed policy makers as well as academic economists.

[1] I am in massive debt to scores of people and some institutions who helped me in many diverse ways along the long path to bring this study to conclusion. I started thinking about this project not long after the 2008 crisis, after I published a study about the slow rise of monetary policy in economics throughout the long nineteenth century (Arnon 2011). During the first phase of moving to research the history of macroeconomics in the twentieth century and particularly how economists analyzed economic crises, I received a grant from The Institute for New Economic Thinking (INET) for which I am grateful. I spent several productive periods visiting the Institute for Research on Labor and Employment (IRLE) at UC Berkeley, was a professorial research associate in the Department of Financial and Management Studies at SOAS, London, and during 2017–2019 was a visiting scholar at the Harvard Kennedy School's Mossavar-Rahmani Center for Business & Government. I completed important parts of the MS in those visits. I would like to express my deep thanks for the support, hospitality and intellectual environment I found along the way. My thanks to scores of persons are recorded in an acknowledgements section that can be found at the end of this Preface. Here, I register my huge debt to Prof. Harald Hagemann who read and commented on all the chapters, criticizing, asking questions, suggesting improvements and raising ideas for further research that are beyond what one usually obtains. The number of people who helped me along the way, in discussions, sharing doubts and also by sending encouragements, as you could see in the Acknowledgments below, is high. None of them is responsible for the views in this book or for any remaining factual errors; they are all my fault; thus, the usual caveat certainly holds for all those I mention.

During the initial phase in the Long Recession, macroeconomists were taken by surprise and the relevance of their theories regarding the fragile economy were seriously lacking. Notably, their shortcomings as to why "It" might really threaten again and significantly, what could be done to avoid such occurrence, were obvious. The question concerning "It"—a second Great Depression—puzzled many at the time, although before 2008 most observers assumed that the question itself was not a legitimate one in macroeconomics. Furthermore, the common wisdom among macroeconomists at the turn of the millennium, just before 2008, was that even a severe, long recession, not to mention the threat of a second Great Depression, could not happen. The evidence was twofold: theoretical and empirical. First, as this book will show, the pre-2008 governing macro thinking found hardly a place for macro failures theoretically. Second, the long period of relative stability known as the Great Moderation, during which fluctuations in macroeconomics faded, convinced the community of macroeconomists that empirical evidence corroborated their theoretical approaches.

Hence, it is no surprise that macroeconomists were almost empty-handed regarding possible policy responses when faced with the 2007–2008 events since the common policy thinking in the early 2000s macro discourse snubbed major macro interventions. As is well known since, the brisk return to what had been called "Keynesian responses" during the early days of the Long Recession, under the looming threat of a new serious economic crisis, stood in sharp contrast with then-dominant macro theories. Intriguingly, the early responses to the Long Recession were implemented by a few macroeconomists, like Ben Bernanke, a distinguished economist, then Federal Reserve chair, who himself carefully studied the Great Depression during the early years of his career. Despite being part of the conventional wisdom up to that moment, he remembered the lessons of the 1930s, was in a position to shape policy responses that were in sharp conflict with his previous views and was obviously an important influence in those dramatic days.

Three of the major US macro policy makers at the time, Ben Bernanke, Timothy Geithner and Henry Paulson—the IMF chair, the president of the Fed of New York and the secretary of the Treasury, respectively—wrote ten years after the crisis a joint book entitled, *Firefighting: The Financial Crisis and Its Lessons* (2019). In it, they described their actions to extinguish the fire and avoid a second Great Depression:

> Along with our colleagues at the Fed, Treasury, and other agencies, we fought the fire with an extraordinary barrage of emergency interventions, escalating from conventional and then unconventional loans to government rescues of major firms and government backstops for vital credit markets. When the fire kept raging, we persuaded Congress to give us even more powerful tools to fight it, including the authority to inject hundreds of billions of dollars of capital directly into private financial institutions. Working alongside an outstanding group of dedicated public officials in the United States and around the world, we eventually helped stabilize the financial system before frozen credit channels and collapsing asset values could drag the broader economy into a second Depression. (Bernanke et al. 2019, p. 2)

The three, representing a non-conventional wing of macroeconomists in the critical months, were confident enough and amply scarred by the events to ignore both their own views up to that point and the lack of proper theory. The fact that they had to quickly adjust their own beliefs of a few weeks before added a personal dimension

to the rolling intellectual macroeconomic drama of 2007–2008 as they described in their writings about the crisis. Their conclusions concerning the profound roots for the fragility in the system, as well as the understanding that they were there to stay, should have become the foundation for a new macro thinking.[2] Naturally they defended active policy and commended the government and, indirectly, their own advice:

> The stress of the 2008 crisis was in some ways—including the declines in stock prices and home prices, and the falls in output and employment—even worse than the early stages of the Great Depression, *but this time the government managed to stop the panic, stabilize the financial system, and jump-start a recovery that continues to this day*. (2019, p. 110; emphasis added)

Thus, they reckon that the government's efforts described in *Firefighting* to "stop the panic" and avoid the threat of a second Great Depression succeeded, though clearly as we shall see they were not based on a well-articulated macroeconomic theory. In the book, we will follow the history of macroeconomic thought, specifically the economists' understanding of crises, to explore how changes in macroeconomics after the Great Depression and up to the Long Recession led to the dismal state of macroeconomics by 2008.

Economic Crises, the Rise and then Fall of Keynesian Economics

The phenomena of economic cycles, the recurrent ups and downs in an economy, described often in the nineteenth-century literature as "excitement and dullness," was well known to economists, first in England where the first Industrial Revolution occurred and then in other capitalist economies. Those who carefully studied instabilities in various economies and particularly, how scholars understood (or misunderstood) those instabilities, observed that "the metaphor of disease vs. health was specifically applied to commercial distress vs. prosperity" by many past thinkers.[3] This clinical concept fits well with what turned out to be a common approach among economists who liked to describe recurring declines in the economy—"illnesses"—as ordinary, and hence, the expected outcomes; they often complemented this observation by treating recoveries as following the illnesses spontaneously. This suited the nineteenth-century political economy's common stance of accepting cycles as

[2] As they wrote: "… the world will face the threat of financial crises as long as risk-taking and maturity transformation remain central to finance, and as long as humans remain humans. Unfortunately, disaster will always be possible" (2019, p. 16).

[3] Besomi (2011, p. 69). One of the famous early descriptions of an economic cycle was Loyd, J. S. [Lord Overstone], (1837), in *Reflections Suggested by a Perusal of Mr. J. Horsley Palmer's Pamphlet on the Causes and Consequences of the Pressure on the Money Market;* see in Loyd's collected works that were put together by McCulloch in 1857: Loyd, S. J. *Tracts and Other Publications on Metallic and Paper Currency*; see also Besomi (2010, 2012).

"natural" occurrences; it was also quite common to embrace passivity concerning possible interventions in the market processes to prevent cycles, interventions that economists used to describe in the twentieth century as macro policy.[4] In the first quarter of the twentieth century, the study of the ups and downs in the economy attracted many economists and the studies of business cycles took center stage in the profession and became one of the more popular subjects in the field.

Over the years, economists' formal sophistication deepened; the profession defined and measured new variables and understood better instabilities. What economists could have known in the past and what they seemed to know at later stages about cycles was not the same. This was of immense importance to the study of business cycles but left a remarkable lacuna in the understanding of crises. Although, drawing a clear distinction between the two concepts—business cycles and crises—is not easy and often the border is hard to define, for the purposes of the present study this is a crucial distinction.

The Great Depression, that most notorious crisis in economic history which started in 1929 and continued up to the Second World War, had a decisive impact on the rise of macroeconomics. Those who followed the events of 2008 will no doubt recall the many references to the Great Depression, not only by the above firefighters, just when the Long Recession of 2008 was starting. The renewed interest in the Great Depression many years after the dismal events took place certainly came as a surprise to the community of economists, especially since its place in research was fading rapidly. Thus, the reappearance of the Great Depression in the economists' discourse was one of the consequences of the stormy events of 2008 that were not anticipated by the profession during the years prior. They were evidence of the economists' fears that another similar event, maybe a Second Great Depression like the Second World War after the (first) Great War, was threatening the world economy.

For many years before 2007, most macroeconomists contended that the dramatic events in the world economy in the 1930s—a crisis, and not a downturn in a cycle—would not repeat itself. They thought that the profession had moved toward a better understanding of what went wrong before and during the Great Depression and had accumulated the knowledge and the necessary tools for preventing "It" from happening again. The common reference to "It" was Hyman Minsky's 1982 book, *Can "It" Happen Again?* Minsky was one of the few dissenting voices among the economists who thought that the answer to the question in his title was affirmative. The majority provided a negative answer: Most academic economists, policy makers, politicians and the public were convinced that "It" would not occur again. They based their answer not only on theoretical arguments which "proved" that the recurrence of another big crisis was improbable, but also on strong support from macro facts: In the post-1945 years, and especially in the last quarter of the twentieth century and up to 2007, the macro performance did not confront a major crisis and the cycles that had continued were much less volatile. The smoother fluctuations of macro

[4] On the slow rise of monetary policy in the nineteenth century, after an early attempt to suggest the idea by Henry Thornton (1760–1815), see Arnon (2011). Wicksell, to whom we will turn in Chapter One, was to rediscover the idea, not knowing at the time about Thornton's work.

variables since the mid-1980s had been termed in the economists' circles as "The Great Moderation" era; a term, apparently coined by Robert Lucas, the Chicago Nobel laureate, that captured the common wisdom among macroeconomists who proudly declared their success in flattening cycles and rendering any worries about the threat of another crisis obsolete.

The comprehension among some theoreticians and a few decision-makers during the last months of 2007 and particularly in 2008 that the world was not behaving in line with the above perception of the macro economy, i.e., it was not following the thinking behind the Great Moderation, threw a few of them back to the traumatic experiences of 80 years before. Hence, they started looking back for lessons that might be relevant for this new striking downturn in the world economy. Many post-2008 studies compared the data on the Great Depression with that of the unfolding Long Recession; some related the first year of the new recession to that in the Great Depression and found surprising similarities. Thus, the possible threat of another depression was hanging in the air in 2008, although it rapidly gave way to a more moderate perspective on the events in later years, after the threat of a crisis faded and the community of macroeconomists gained confidence that 2008 was a downturn but not "It" again. What we faced starting in 2009, they argued, was a slump that is mostly known since as the Long Recession or what some call the Great Recession.

This book focuses on the major developments in macroeconomic thinking since the Great Depression, which essentially turned the "Great Moderation" from solely an empirical phenomenon into nearly a corroboration of the newly formulated theoretical foundation of macroeconomics, known as New Classical Macroeconomics.[5] Moreover, before the first decade of the new millennium this perspective turned hegemonic. The intellectual process that transformed the sub-field of macroeconomics from one perceiving the economy as inherently unstable—hence in need of macro policy—to where it was by 2007, perceiving the economy as essentially a stable system—which needed less macro policy—will be reviewed. As we shall see, the changes in macroeconomics thinking were a long and compound process. Our appraisal will concentrate on the most significant theoretical changes in macroeconomics, those that contributed most to molding the process that brought us to the "empty hands" theoretical position described above. The process that altered macroeconomics since the 1930s was shaped significantly by the work of macroeconomists who relied on theories and empirical knowledge, but who also reflected political, cultural and broader social transformations.

Robert Lucas's presidential address to the American Economic Association in 2003 was characteristic of the conceptualization known as the Great Moderation and, in retrospect, was very influential and thought-provoking. A quote from Lucas's opening statement to the annual gathering of the American economists is telling:

> Macroeconomics was born as a distinct field in the 1940s, as a part of the intellectual response to the Great Depression. The term then referred to the body of knowledge and expertise that we hoped would prevent the recurrence of that economic disaster. *My thesis in this lecture is that macroeconomics in this original sense has succeeded: Its central problem of depression*

[5] New Classical Macroeconomics, in its various forms will be discussed in Chap. 11.

> *prevention has been solved, for all practical purposes, and has in fact been solved for many decades.* (Lucas, 2003, p. 1; my emphasis)

Thus, macroeconomics, the sub-discipline of economics that was born from the Great Depression and which owes its origins to that chaotic period, succeeded dramatically in molding reality so that depressions were no longer a problem and, as Lucas argued, would not be one again for many decades to come. It is remarkable that less than five years later the AEA annual conference of American economists, many of them agreeing with Lucas at the time and more than a few of whom were in decisively influential positions, stood shocked and empty-handed in the face of the clear warnings that "It" was in the air again.

Why was the state of macro so unfit and incompatible in the face of the threat of a crisis in 2008? What happened in the years between the Great Depression and Great Moderation, mainly after the 1960s, that left the sub-discipline of macroeconomics so ill-prepared in the face of the specter? How did a discipline which grew out of the attempts to explain instabilities in the economic system as a whole and possibly to suggest policy cures, presume that the problem "has been solved" both then (in 2003) and for the coming decades? What made the profession seem so totally out of touch with reality when it was suddenly called to recognize that the worst bust since the Great Depression was happening? Clearly, most economists in 2007–2008, many more than would accept it today, were in a state of shock and denial. They had been convinced by the profession's conviction that "It" was no longer a possibility. Even more surprising, at least to those outside of the economic profession, the introspection of (most) economists after the events, was short lived, if at all, and I would suggest, relatively shallow. In spite of the Long Recession, a few years in the making depending on the country, economists seemed to argue that the Great Moderation thesis was not part of the problem. Hence, it seems that only a few systematic efforts to trace the rise of the thesis and explore its faults were written by leading macroeconomists since the Long Recession had started in 2008.

In this book, I would like to utilize an oft-neglected sub-discipline of economics that is dedicated to the history of economic thought and probe into the changes in macroeconomic thinking since the Great Depression. I will argue that by the time that the ghost of a new major crisis threatened, the profession had already adopted a version of macroeconomics that presumed no abnormal times such as another big crisis could occur. As noted above, after a short process of inward introspection, including the above reexamination of the Great Depression, the profession largely just ignored the crumbling times of 2008. The profession concluded, implicitly at least, that "It" could not happen again (again) due to its better understanding of the economy, even in times of bust, due to the appropriate tools that were subsequently developed. While it is true that a Second Great Depression did not happen, many economists would agree that we were very close to such a dismal occurrence. Only a few bothered to look back at the development of macroeconomics itself and ask how we got the understanding of the threat so wrong.

Thus, I would like to tell the story of how a profession, born in a crisis, lost somehow at least part of its collective memory. I will explore how the lessons of the

Great Depression evaporated to some extent, and with them also certain of the skills necessary to encounter a new major storm. The story that will be told is not easy to accept and the lacuna in macro theory is not obvious to many including, naturally, most economists. And as we shall see, the unfortunate state of macroeconomics theory concerning crises at the turn of the twenty-first century was the result of many prolonged debates among economists over numerous key issues which reflected the combined results of different theoretical positions. However, as I will show, it seems that there are several unifying themes in the dismal story concerning macroeconomics theory and its view of crises over the time span being analyzed.

The theoretical lessons of the Great Depression era emphasized the uniqueness of the analysis of a whole economy—hence the creation of the sub-field name, macroeconomics—representing a different way of thinking with different lines of inquiry from those suitable for individual markets, known since the 1930s as microeconomics. On the other hand, one of the most obvious tenets of the "New Macro" at the turn of the twenty-first century, represented by New Classical macroeconomics, was to abandon or at least to blur and confuse, the significant distinction between micro- and macroeconomic analysis. Essentially, the "New Macro" adopted and was an extension, of the analysis and techniques used in micro.

The book will chart the pioneering work of Knut Wicksell at the turn of the twentieth century; the economic debates in the 1930s, covering the core contributions and impact of John Maynard Keynes and Friedrich von Hayek; the rise of Keynesianism in the 1950s and its decline since the 1970s; the ascent of Monetarism in the 1960s; and the dominance of New Classical thinking in its different forms since the 1980s. Throughout the discussion, the book will consider the relative quiescence of the Austrian economists for many years after the 1930s through the rise in their influence over recent decades. The period covered includes the important debates that molded modern macro policy in the world between the two world wars, mainly as a response to the Great Depression, continuing through the Cold War years with the debates on the welfare state, planning and free markets, to the years following the collapse of the Soviet system in the late 1980s.

The book provides detailed studies of several of the period's major macro theorists, emphasizing how they analyzed both cycles and crises and how they reached their conclusions on the sort of policy, if any, a capitalist society should adopt. In presenting the theoretical frameworks of each economist, we will evaluate them as tending to have a more "active" or "passive" approach to intervening in the economy based on their views on the economy's tendency to spontaneously avoid cycles and crises while reaching both growth and stability. We will distinguish between the type of economic regime each of the various theorists preferred, characterized by the exchange rate regime and the structure of the monetary, banking and financial systems and by the specific interventions (if any) that they recommended within that regime. We will focus on the theorists' answers to the following questions:

- How can one explain cycles and crises in the economy?
- How should one address cycles and the threats of crises in the capitalist system?

- What are the roles of the visible hand (policy) and the invisible hand (markets) generally, and how are they to function in exchange rate determination, in money, credit and banking and, notably, in the financial system?
- What roles should "rules" and "discretion" play in economic policy making?
- What is the influence of the monetary and financial systems on macroeconomic aggregates, such as the price level, output, unemployment and the accumulation of wealth?

And finally,

- What is the proper role of monetary, fiscal and more broadly, macro policy in the economy?

After presenting the various main tendencies, the final part of the monograph will explore the split in economic theory between micro and macro after the birth of macro in the 1930s and the later attempts, since the 1970s, to base macro on what is known since as microfoundations for macro. The reasons for the dramatic rise in "active" macro policy after the Great Depression, with the success of Keynesian ideas and the intriguing rise of a far more "passive" macro policy during the years leading to the Long Recession, will be studied. Thus, we will attempt to shed light on the varied sources behind the highs and lows of the analytical tendencies discussed in the book whose ideas continue to attract economists and to play an important role in public discussions. In the final chapter, the Epilogue, we will briefly assess the state of macro thinking a decade after the start of the Long Recession.

For some, the return of the shadows surrounding the Great Depression were just a unique and exceptional "perfect storm" that happen so rarely that we should think about it as an accident. The fact that the darkest moment of summer 2008 gave way to less alarming economic events made this perspective increasingly popular. Thus, though the alarming moments happened and almost no economist could deny their presence in the summer of 2008, soon afterward most economists allowed themselves to ignore the "accident" and continued predominantly with what they thought they knew so well before the crisis took them by surprise.

We can appeal to the psychology of the individual, who so often goes back to "normal" after a shock, and apply it to the collective professional response. Still, for a sub-field that grew out of the worst economic disaster in history to have such strong predispositions to forget, ignore and even embrace denial characteristics, is strange and calls for explanation. It really requires a second look at what transformed 1930s macroeconomics from an intellectual framework capable of explaining the Great Depression into one that is embedded in thinking that the Great Moderation is here to stay.

The scholars who studied cycles and crises in the 1930s were not less arrogant, it seems, than their peers 50 or 80 years later. But Keynes and Hayek, scholars who addressed cycles and crises in the 1930s, researching them theoretically and inquiring into policy consequences, and who along the way helped to produce macroeconomics as we will see, were more modest than modern scholars when it comes to knowledge of the whole economy. They witnessed "It" happening in the 1930s and they did

not think that "It" could not happen again. Their view of the economy, the forces that shaped the various parts, their interlinkages and the possible abnormal outcomes of the whole did not exclude a dramatic departure from normal times, though their perceptions were quite diverse. The debates between these two influential scholars and later, between those who swear to their heritage, as we shall see, sketch out the disappointing path of macroeconomics from the Great Depression through the Great Moderation to 2008 and the Long Recession.

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I thank the copyright holders of the "Milton Friedman papers at Hoover Institution Library and Archives," for permission to quote a letter from Milton Friedman to Friedrich A. Hayek. The letter was found at the "Friedrich A. von Hayek Papers, Hoover Institution Archives, Stanford University."

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