

PAVEL POTUZAK

University of Economics, Prague, Czech Republic

PRICE LEVEL STABILIZATION: HAYEK AND NEW KEYNESIANS

Abstract:

The doctrine of price level stabilization is one of the most important building blocks in modern macroeconomics. In 1920s and 1930s, Friedrich August von Hayek presented a theory that challenged this monetary-policy regime. Hayek stressed that attempts to stabilize the price level in the situation of a growing natural output might cause serious injection effects leading the economy to a boom-bust cycle. This article compares the Hayek theory with the New Keynesian doctrines. A simple graphical model is used to elucidate differences between the two theories. It is suggested that a declining price level might be a normal response of the price system in the expanding economy because the New Keynesian arguments stressing price rigidities may be of lower significance when the deflation in prices is caused by technological progress.

Keywords:

Price level stabilization, business cycle, natural rate of interest

JEL Classification: E42, B25, B53