**Alternate Theories**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Classical** | **Keynesian** | **Monetarism** | **Rational Expectations** |
| **Chief Proponent** |  |  |  |  |
| **Stability of the economy** |  |  |  |  |
| **What causes instability in the economy** |  |  |  |  |
| **Price and wage assumptions** |  |  |  |  |
| **Appropriate policies** |  |  |  |  |
| **How money supply changes impact the economy** |  |  |  |  |
| **How fiscal policy impacts the economy** |  |  |  |  |

# Alternate Theories Answer Key

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Classical** | **Keynesian** | **Monetarism** | **Rational Expectations** |
| **Chief Proponent** | *Adam Smith* | *John Maynard Keynes* | *Milton Friedman Anna Schwartz* | *Ronald Lucas* |
| **Stability of the economy** | *Stable in the long run* | *Unstable* | *Stable in the long run* | *Stable in the long run* |
| **What causes instability in the economy** | *Inappropriate monetary policy* | *AS shocks**AD changes (Investment ≠ Savings)* | *Inappropriate monetary policy* | *Unanticipated AS/AD shocks* |
| **Price and wage assumptions** | *Wages and prices are fully flexible* | *Wages are sticky and prices are downwardly inflexible* | *Wages are sticky but prices are fully flexible* | *Wages and prices are fully flexible* |
| **Appropriate policies** | *Let the economy self-adjust* | *Fiscal & Monetary policy as needed* | *Use the monetary rule (MV* = *PY)* | *Use the monetary rule (MV* = *PY)* |
| **How money supply changes impact the economy** | *Changes in the money supply increase price level but do not change output* | *Changes in the money supply change investment and consumer spending shifting AD to the right* | *Changes in the money supply directly change AD which changes output* | *There is no effect because price level changes are anticipated* |
| **How fiscal policy impacts the economy** | *Fiscal policy would only worsen the situation causing more inflation or a deeper recession* | *Change in AD that change output through the multiplier process* | *Fiscal policies don’t change output unless the money supply changes* | *There is no effect because price level changes are anticipated* |