

Homework

What is Keynesian Economics?

An economic theory of total spending in the economy and its effects on output and inflation. It was developed by the British economist, named "John Maynard Keynes", in the 1930s. The key is to understand the Great Depression.

How does the theory work?

He advocated for increased government expenditures and lower taxes to stimulate demand and pull the global economy out of the depression.

The concept is to achieve economic performance by influencing aggregate demand, which is why Keynesian economics is considered as a "demand-side". A change in the economy in Short Run.

Understanding of Keynesian Economics

Keynesian economics represented a new way of looking at spending, output, and inflation. The economics disputes that lower wages can restore full employment, because employers will not add employees to produce goods that cannot be sold because demand is weak. There will be a negotiation between them. Moreover, poor business conditions may cause companies to reduce capital investment. It is a high risk for them to invest at a lower price.

Understanding of the Classical economics (contrary of Keynes's)

In contrast, the classical economics thinking believes that when cyclical swings the economic output and workers will adjust themselves. When demand falls, prices and wages will be reduced. It will cause a decrease in the level of inflation. Accordingly employers will employ more labor, which will restore the economic growth.

Keynes' perspective on Great Depression

In classical economic theory, it is argued that output and prices will eventually return to a state of equilibrium. But, he rejected it, arguing that once an economic downturn sets in, for whatever reason, the fear and gloom that it engenders among businesses and investors will tend to become self-fulfilling and can lead to a sustained period of depressed economic activity and unemployment (loss in confidence).

Possible solutions to Great Depression

He advocated a counter cyclical fiscal policy, in which the government should undertake deficit spending and boost consumer spending in order to stabilize aggregate demand. Moreover, he proposed that the government spend more money, which would

increase consumer demand in the economy. The result would be recovery and reduction in unemployment.

Pros and cons of monetary policy

Pros: The slow change in prices makes it possible to use money supply as a tool and change interest rates to encourage borrowing and lending. Short-term demand increases initiated by interest rate cuts reinvigorate the economic system, restore employment, and demand for services. The new economic growth.

Cons: Keeping interest rates low is an attempt to stimulate the economic cycle by encouraging businesses and individuals to borrow more money. Thus, businesses and individuals increase their spending. The new spending stimulates the economy. Lowering interest rates does not always improve the economy.

Pros and cons of fiscal policy

Pros: According to the multiplier, An injection of government spending added business activity and even more spending. This theory proposes that spending boosts aggregate output and generates more income. If workers are willing to spend their extra income, the resulting growth in GDP. Related to MPC, spending from one consumer becomes income for another worker, and worker's income can then be spent and the cycle continues.

Cons: Other economists showed that Keynesian models misrepresented the relationship between savings, investment, and economic growth. There is also the money multiplier, which is less controversial than its Keynesian fiscal counterpart.

Keynes' perspective on saving and economic growth

Keynes and his followers believed individuals should save less and spend more, raising their marginal propensity to consume to effect full employment and economic growth. (the paradox of thrift)

Alternative theory on saving and economic growth

The New Growth:

An economic concept that humans' desires and unlimited wants raise productivity and economic growth. The new growth theory argues that real gross domestic product (GDP) per person will perpetually increase because of people's pursuit of profit. So, if there is no increase in profit, saving will always remain.

