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THE SUMMARY OF KEYNESIAN ECONOMICS

What is Keynesian Economics?

The Keynesian Economics is sometimes referred as a "depression economics" and it was developed in 1930s by John Maynard Keynes, the British economist. In that time, there is a great depression in economy and Keynes can make the global economy to be in a better situation. Keynesian economic is a theory that considers as a "demand-side" theory. This theory focus on changes in the economy in the short run terms, and also on how to prevent the economic recession by using government policy.

In 1936, Keynes's General Theory was written in the time that there is a worldwide deep depression. This book was informed by directly observable economic phenomena arising during the Great Depression, which could not be explained by classical economic theory. Keynes rejected the idea that the economy would return to a natural state of equilibrium and in that time Keynes was highly critical of the British government.

Possible solutions to Great Depression

In this case, when the economy is in the depression situation Keynes support the government that they should make up for the decline in investment and boost the consumer spending in order to stabilize aggregate demand.

Keynes' perspective on saving and economic growth

Keynes criticized the idea of excessive saving, unless it was for a specific purpose such as retirement or education . Keynes saw that it is dangerous for the economy because he believe that the more money sitting stagnant, the less money in the economy stimulating growth.

<u>Pros and Cons of Fiscal Policy</u> : determines the way in which the central government earns money through taxation and how it spends money. To assist the economy, a government will cut tax rates while increasing its own spending; to cool down an overheating economy, it will raise taxes and cut back on spending. There is much debate as to whether monetary policy or fiscal policy is the better economic tool, and each policy has pros and cons to consider.

~Pros

- Can direct spending to specific purposes
- Can use taxation to discourage negative externalities
- Short time lag

~Cons

- May be politically motivated
- Tax incentives may be spent on imports

Can create budget deficits

<u>Pros and Cons of Monetary Policy</u> : involves the management of the money supply and interest rates by central banks. To stimulate a faltering economy, the central bank will cut interest rates, making it less expensive to borrow while increasing the money supply. If the economy is growing too rapidly, the central bank can implement a tight monetary policy by raising interest rates and removing money from circulation.

~Pros

- Interest rate targeting controls inflations
- Can be implemented fairly easily
- Central Banks are independent and politically neutral
- Weakening the currency can boost exports

~Cons

- Effects have a time lag
- Technical limitations
- Monetary tools are general and affect an entire country
- The risk of hyperinflation

Alternative theory on saving and economic growth

While savings were strictly linked to income sources by Classical and Post-Keynesian theories, simple partial-equilibrium models explain individual saving decisions in the light of private investment returns and labour-income dynamics. If optimal saving decisions are embedded in a dynamic general equilibrium framework of analysis, however, the parameters of individual saving problems are jointly determined by aggregate savings and investment outcomes, and ultimately by the character of income distribution at the aggregate level.