Keynesian Economics

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- Keynesian economics is a macroeconomic economic theory of total spending in the economy and its effects on output, employment and Inflation. Keynesian economics is considered a "demand-side" theory that focuses on changes in economy over the short run.

- Keynes dubbed classical economic thinking held that cyclical swings in employment and economic output create profit opportunities that individuals and entrepreneurs would have an incentive to pursue, and in so doing correct the imbalances in the economy. Keynes argued against his construction of classical theory that during recessions business pessimism and certain characteristics of market economics would exacerbate econo weakness and cause aggregate demand to plunge further.

- Keynes' General Theory was writtien during a time of deep depression. Keynes rejected the idea that the economy would return to natural state of equilibrium by itself, Great depression seemed to counter this theory. The Great Depression inspired Keynes to think differently about the nature of the economy. From these theories, he established real-world applications that could have implications for a society in economic crisis.

- Keynes advocated a countercyclical fiscal policy in which, during periods of economic woe, the government should undertake deficit spending to make up for the deline in investment and boost consumer spending in order to stabilize aggregate demand and a reduction in unemployment. He believed the governmet was in a better position than market forces when it came to creating robust economy.

- Keynes's theory of fiscal stimulus, an injection of government spending eventually leads to added business activity and even more spending. This theory proposes that spending boots aggregate output and generates more Income. If workers are willing to spend their extra income, the resulting growth in the GDP could be even greater than the initial sitimulus amount.

- On Other hand, Keynesian model misrepresented the relationship between savings, invesment, and economic growth. Many economist still rely on multiplier-generated models, although most acknowledge that fiscal stimulus is far less effective than the original multiplier model suggests.

- Monetary policy use money supply as a tool and change interest rate to encourage borrowing and lending. Lowering interest rates is one way governmets can meaningfully intervene in economic systems, thereby cosumption and investment spending. Short-term demand increses initiated by interest rate cuts reinvigorate the economic system and restore employment and demand for services. The new economic activity then feeds continued growth and employment.

- Lowering interest rates, however, doesn't always lead directly to economic improvement. As interest rates approach zero, stimulating the economy by lowering interest rates become less effective because it reduces the incentive to invest rather than simply hold money in cash or close substitutes like short term treasuries. Interest rate manipulation may no longer be enough to generate new economic activity if it cannot spur investment, and the attempt at generating economic recovery may stall completely. This is a type of liquidity trap.

- Keynes also criticized the idea of excessive saving, unless it was for a specific purpose such as retirement or education. He saw it as dangerous for the economy because the more money sitting stagnant, the less money in the economy stimulating growth. This was another of Keynes's theories geared toward preventing deep economic depresions.

- The paradox of thrift is an economic theory that argues that personal saving can be detrimental to overall economic growth. It is based on a circular flow of the economy in which current spending drives future spending.