

Keynesian Economics

A British economist John Maynard Keynes was the person who developed Keynesian economic theory regarding the total spending in the economy and the effects on output and inflation. Keynes favors higher government spending and lower taxes to generate more demands which his core aim is to recover from the depression. This theory was established during the time of the Great depression, where Keynesian Economics was applied to reach economic performance and prevent the economic collapse and fluctuation. By stabilization powerbroker and government intervention through economic policies to influence aggregate demand. So, Keynesian economics can also be known as 'depression economics'. However, this theory acknowledges only the 'demand-side' changes during the short-run.

Keynes's view and solutions on the Great depression

During the Great depression, governments decreased government spending and increased taxes. However, Keynes denied that the economy will return to equilibrium, so he created theories that can be applicable in a real economic crisis. Keynes has mentioned that what the government did during the Great depression had negative effects on people's spending, where the economy was not effective and did not turn out to the expected result. Keynes also stated that when the economy faces depression, as a result, people will be discouraged from the fear of the economical situation that can lead to deteriorating economic activities and increasing unemployment. However, the solution that Keynes came up for the recovery from the economic depression was to encourage application of fiscal policy in economic catastrophe, where the government should increase spending to boost the economy by increasing consumer spending to stabilize aggregate demand. This way the economy can increase economic action to regain the natural economic state and reduce unemployment.

Pros and Cons of Fiscal policies

According to Keynes, the increase of government spending will stimulate business activity and money circulation and spendings. So, this will benefit the economy by boosting the aggregate output which can also increase income of employees. Furthermore, when employees receive more income, it will also result in higher income spending and growth in gross domestic product(GDP). Moreover, the effect of fiscal policy tools can be seen much quicker than monetary policy. On the other hand, it can cause a crowding-out effect, where the government aims to increase spending to generate higher output. But they fail to deliver expected results, like decrease in Y .

Pros and Cons of Monetary policies

Lowering interest rates can also be one of the solutions to stimulate active economic demand, which can encourage people to borrow. Which again leads businesses and individuals to spend more, which can improve the economy from the worst conditions. However, there is uncertainty in lowering tax, where it does not always lead to economic improvement. Lowering tax can lead to a liquidity trap, where the policy applied is no longer effective due to too low interest rates. So, people will prefer to save rather than investment.

Keynes's view on Savings and Economic Growth

Keynes contradicted the excessive saving concept. As his prospect of excessive saving was unsafe and threatening to the economy due to more inactive money, which these money can be used to encourage economic growth. Unless the money was kept for future purposes, such as retirement or education. Ultimately, Keynes believed that during the economic crisis, the government should take actions by various economic policies rather than just waiting for the economy to return to the natural state by itself, which have mentioned in other economic theory.

The Solow Growth Model

The Solow growth model is also a model which is related to saving and economic growth. This exogenous model of economic growth analyzes the changes in the level of output in the economy due to the changes in population growth rate, the saving rate and etc. during a certain time period. The Solow model stated that a sustained rise in capital investment would increase the growth rate only temporarily due to the proportion of capital to labor. However, the marginal propensity of additional units of capital can decline as there are diminishing returns. Thus the economy will again forward to a long-term growth path with real growth in GDP and growth of the workforce, which can prove the productivity improvement.