Keynesian Economics- Pros and Cons

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“By a continuing process of inflation, government can confiscate, secretly and unobserved, an important part of the wealth of their” (Keynes, 1912), was a quote by one of the most famous economics ever around. John Maynard Keynes was the economist who revolutionized the economic way of thinking during the great depression. He introduced Demand-side economics or as people also say, “Keynesian Economics”.

Keynesian side economics has been a great help ever since being introduced by John Maynard Keynes during the great depression. Before the great depression, economies used to run the economy using the classical economists view point. When it came to the great depression, classical economists’ way of curing the great depression did not seem to be helping the economy. Therefore, John Maynard Keynes, a British economist wrote a book on “The General Theory of Employment, Interest and Money” which introduced a new perspective to running a successful economy. First of all classical economists used to believe that supply creates demand but Keynes’ book claimed that a demand creates its own supply. This was a completely different idea to the people and experts out there. In Keynes’ book, he also said that in order to fix the economy back to full employment from the great depression, the government needs to step in whereas classical economists believed that the economy would go back to full employment by itself as time passes without the government having to interfere. Keynesian economics then came out on top and using its way of running the economy, the great depression did not last long and therefore the economy went back to full employment. Other than classical economics there is also the Monetarism way of running an economy. Monetarism is another school of economics where it is
thought how the creation of money causes inflation and how the government and help the
economy by the use of money supply. Keynesian Economics which has been and is widely
recognized all around the world since the great depression has both its pros and cons. The
Pros/advantages of Keynesian economics are inflation, employment/ job creation, lowered
nominal interest rates, improved infrastructure and finally it addresses needs of the Economy.
The cons/ disadvantages of Keynesian Economics are inflation, budget deficits and policy lags.
Depression has both its pros and cons. (Arumugam, 2010)(Mohr, 2006)

Before Keynesian Economics was introduced, Economics was always viewed in the
perspective of classical economics that supported say’s law. Say’s Law stated that Supply creates
demand. Classical Economics had their own way of looking at the economy and Keynes had his
own way while they also have similarities. Then later came Monetarism, which regarded mostly
money supply. In the following paragraphs, these topics will be addressed.

Keynesian Economics is the brainchild of the great economist, John Maynard Keynes. The
Keynesian school of economics considers his book, "The General Theory of Employment,
Interest and Money” which was published in response to the great depression as its holy Bible, in
other words everything needed to run as a Keynesian Economy. He Introduced the new idea of
an opposing theory to say’s law which was that demands creates it own supply. During the Great
Depression, Keynes proposed that the government should take action in order or the government
to achieve back full employment because the economy can't do it itself. (Laurence, 1996)
The Classical economics theory is based on the premise that free markets can regulate themselves back to full employment from great depression without government intervention. Adam Smith was the guy who was a strong Classical Economist. The classical Economist supported and promoted Say’s law which stated that supply creates its own demand. The classical economists during the great depression just sat back and expected the economy to regulate itself back to full employment as they believed that when the prices are adjusted, the demand would also be triggered. Adam Smith's book, 'The Wealth of Nations', was the start of a worldwide Classical wave, that focused on there being an invisible hand (adjustments in prices automatically) that moves markets towards a natural equilibrium, without the requirement of any intervention at all. (Laurence, 1996)

Monetarism is a set of views based on the belief that inflation depends on how much money the government prints. It is closely associated with Milton Friedman, who argued, based on the quantity theory of money, that the government should keep the money supply fairly steady, expanding it slightly each year mainly to allow for the natural growth of the economy and when money is needed out there.. Monetarism had its great days in the early 1980s, when economists, governments and investors got excited at every new money supply statistic. In the years that followed, however, monetarism fell out of favor with economists, and the link between different measures of money supply and inflation proved to be less clear than most monetarist theories had suggested. Many central banks today have stopped setting monetary targets and instead have adopted strict inflation targets (Willis, 2005).
The Keynesian, Classical and Monetarist schools of Economics also have things in similar other than only being different. The theories of Keynesian economics, which were written by John Maynard Keynes, are built upon classical economics, founded on the theories of Adam Smith (a classical economist), often known as the "father of capitalism." While Keynes was different from Smith and proposed a completely different idea, he and almost all economics philosophers followed and agreed with some of Smiths’ founding principles. To understand the similarities in Keynesian and classical economics, it's important to understand the basics of each and their relationship to one another. All three schools of economics believed that when money joins the situation, there has to be a change in the economy. In conclusion, all three schools of economics’ ideas come from the same origin and go separate ways after that.

In short, Keynesian, Classical, Monetarist economics are similar in a few ways yet very different and lead to different approaches. Keynesian economics state that demand creates supply while classical economics states that supply creates demand. Classical economics does not support government interventions in triggering the economy while Keynesians do support it. Monetarist Economics is mainly based on the idea of how money supply can help decrease or increase inflation. Inflation is supported and mostly only caused by Keynesian economics and Monetarists while classical economist don't really have it since the government does not do anything much to make the economy achieve back full employment rate.

Keynesian Economics has various pros and cons that will soon be discussed. Here are some pros of Keynesian Economics. While running the economy using Keynesian School Of Economics, Inflation has to occur. Keynesian Economics encourages the creation of more jobs
compared to other schools of economics. There are lowered nominal interest rates. It improves infrastructure.

One of the major advantages of Keynesian economics is that it causes inflation. Inflation is good because it makes people invest and use more of their money. All these result in a greater GDP which is better for the nation. Company owners increase the wages of their workers in order to make them happy. Therefore, prices of their goods and service increase correspondingly in order to achieve the same profit they were receiving before. Regarding all this the government produces more money. Inflation also causes people to use more of their money rather than keeping it since the value of money keeps on decreasing resulting in indirect effects on the countries GDP shifting right on the graph or in other words inflation encourages growth for/ in the economy. (Laurence, 1996)

Another major advantage of Keynesian economics is increase in employment or job creations. Keynes advised the government to create more jobs, which would eventually trigger the economy due to more work put. (Fontana, 2003) The government can create more jobs by hiring non-skilled people to dig holes and other things that could be learned easily and did not require much intelligence just to get the people with no jobs working and generating income. Keynesian school of economics also encourage government in cutting taxes or increasing taxes to trigger the economy, therefore, when there is a very high unemployment rate that the government would cut taxes resulting in a higher employment rate.
Additionally, lowered nominal interest rates is another major advantage of Keynesian economics. Keynesian Economics enforces lowering the nominal interest rates to increase investment. As interest rates decrease, investments increase is a statement by Keynes. To back it up, in other words, when there is a lower interest rate, people will get very low by saving their money in the bank and would get much more by investing, also more people who were doubtful in taking loans from the bank at a higher interest are more likely to take loans after the decrease. This process increases investment in businesses thus creating more goods and services. All this results in an increase of aggregate GDP in the economy. (Setterfield, 2007)

Moreover, Keynesian Economics also improved infrastructure. As mentioned earlier, Keynesian Economics emphasizes the idea of government intervention, therefore in order for an economy to recover from recessions, to trigger employment rate, or to increase a country’s GDP, the government needs to make bridges and roads. Thus, there is improved infrastructure.

In conclusion, there are many advantages of following the Keynesian school of Economics. While running the economy using Keynesian School Of Economics, Inflation has to occur. Keynesian Economics encourages the creation of more jobs compared to other schools of economics. There are lowered nominal interest rates. Finally, it improves infrastructure.

As it has been shown, there are various advantages of Keynesian economics but there are also many disadvantages of following the Keynesian school of economics too. Keynesian Economics has three major disadvantages. While inflation is an advantage of Keynesian Economics, it is
also a leading disadvantage ironically. Keynesian Economics causes budget deficits. When a government follows the Keynesian School of Economics, there are policy lags.

While Inflation is an advantage of Keynesian Economics, it is also a leading disadvantage ironically. “Opponents of the Keynesian approach, including many conservative economists, have argued that higher government spending provides excessive stimulus to the economy, raising prices for consumers and businesses.” (Setterfield, 2007) First of all, Keynes believed that government intervention is very important into restoring the market back to full employment; therefore when there is a recession, the government spends more. When the government spends more, it affects the market as many times as the spending multiplier is therefore a large amount mostly. The quotation above basically means that when the government spends more, it normally provides excessive stimulus to the economy therefore causing inflation. (Sweezy, 2012)

Secondly, Keynesian Economics causes budget deficits. When there is a recession, output declines as a result of reduced activity. In this case, according to Keynes, government needs to increase spending in order to compensate for the decline of output and aggregate demand. The money that the government uses is generally borrowed which increase government deficits and raises the nation’s debts. As these debts grow, the amount of interest needed to pay increase proportionally therefore leaving the government with less money for government activities such as education and infrastructure. (Richman, 2009)

When a government follows the Keynesian School of Economics, there are policy lags. “Because excessive demand causes inflation to rise and insufficient demand leads to higher
unemployment, demand-side economics often requires regular government action such as reduced spending in a healthy economy and higher spending in weaker times. The problem is the lag between recognition of the need for government action and the actual implementation of appropriate policy measures.” (Stewarts, 2007) Very often at times, the process of making the policy is what delays the adoption and implementation of policy measures. Further on, there is lag between the policy itself and the effects resulting from it. These processes may take months which is not good for an economy.

In conclusion, even though Keynesian Economics has many advantages, there are disadvantages to it also. Keynesian Economics has three major disadvantages. While inflation is an advantage of Keynesian Economics, it is also a leading disadvantage ironically. Keynesian Economics causes budget deficits. When a government follows the Keynesian School of Economics, there are policy lags. (Richman, 2009)

As a whole conclusion, Keynesian economics have many pros and cons but according to research, it proposes the most efficient way to run an economy understanding the disadvantages that come along with it. The Pros/advantages of Keynesian economics are inflation, job creation, lowered nominal interest rates, and finally, improved infrastructure. The cons/ disadvantages of Keynesian Economics are inflation, budget deficits and policy lags. While there are other economic ideas and perspectives of running an economy, following the Keynesian school of Economics, results to be the most adequately efficient and healthy for an economy.
Resources


