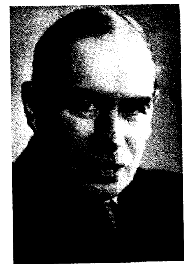
John Maynard Keynes (1883-1946)
<u>KEYNSIAN ECONOMICS</u>

John Maynard Keynes was such an influential economist in the 20th century that an entire school of modern thought bears his name. Many of his ideas were revolutionary and almost all of them were controversial.



Keynes was born in Cambridge, England, where he also attended King's College, earning a degree in mathematics in 1905. After university he worked for the British Civil Service which was where he wrote his first of many economic books *Indian Currency and Finance*; a detailed account of the monetary system in India. He returned to Cambridge for a short while as a lecturer then took a job for the British Treasury. He was Britain's representative on monetary issues at the Treaty of Versailles which ended World War I. However, he resigned from his position at Versailles as he believed the treaty and financial decisions against Germany were too burdensome for their economy.

Upon his return to England, Keynes wrote *The Economic Consequences of the Peace*, a further explanation of why he resigned at the Treaty of Versailles. In his book he stated that Germany could never repay its war debt and would stay poor until some drastic political action was to take place. We know today that he was entirely correct!

In the 1920s Keynes became an avid supporter and believer in the ***Quantity Theory of Money*** – today we call this **MONETARISM**. His view is:-

- The way to stabilize the economy is to stabilize the price level
- The government's central bank must lower interest rates when prices begin to rise
- The government's central bank must raise interest rates when prices tend to fall

What Keynes did not calculate in his theory was a high rate of unemployment. Between World Wars, the unemployment rate in Britain rose to 20% which changed his findings so he recalculated using other causes of economic disasters and wrote a second book called *The General Theory of Employment, Interest and Money*. This book soon became simply known as Keynes's *General Theory* and introduced the following:

1. the notion of aggregate demand as the sum of consumption
   (the total demand = the total consummation)

2. full employment could be maintained only with the help of government spending and investment

Economists still argue about what Keynes thought caused high unemployment. Some think he attributed it to wages that take a long time to fall. Keynes actually wanted wages <u>not</u> to fall. According to Keynes,

- Wages should be kept stable
- A general cut in wages would decrease income, consumption and the total demand within an economy
- This would offset any benefits to output that the lower price of labor might have contributed

The General Theory **stated that the government must use deficit spending during economic downturns to maintain full employment**

The best example of this was in the U.S.A. during the Great Depression. Previous governments used a balanced budget. The New Deal put people back to work on public works projects. Over time, the unemployment rate improved and the depression came to an end. Unfortunately, the idea introduced by Keynes, deficit spending, is still used by policymakers today despite there being another "Great Depression."

Keynes was a strong advocate for Free Market Economies. He believed that once full employment had been achieved by fiscal policy measures, the market mechanism could then operate freely.

Little of Keynes's original work survives in modern economic theory. His ideas have been endlessly revised, expanded and criticized. Keynes used macroeconomic models for his theories and even though they are no longer used, many of the world's best economists today owe thanks to John Maynard Keynes and the influence of his ideas of economics.