

# Good research paper on classical and keynesianism

[Business](#), [Marketing](#)



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Classical model of the economy has weaknesses that Keynes took advantage of to come up with the Keynesian model. In the classical view of the economy, the belief is that the market will always tend towards providing full employment and that people were satisfied with what the real world is described to be (Caporaso, 1992). However, this belief could not hold any water when the Great Depression started in the economy. It was at this time when economists wanted a more rational way of formulating economic policies. The operations of the market in the view classical theorists failed to sustain the economy at the times of Economic Depression. In response to economic challenges, Classical theory is perceived to be too slow to provide solutions to economic challenges. As such, Keynes argued that natural market forces are too slow and should not be relied upon while dealing with an economy that is faced with crises such as war.

In view of Keynes, waiting on natural market forces to restore an equilibrium will lead to huge losses of lives before a desirable outcome is realized. The theory comes in handy to provide quick response to an economy that is

burdened with issues. The theory got published officially in 1936 as a justification of deficit. Keynes believes that market failures can be systematic rather than the idea that market can achieve self-regulation as argued by the classical pioneer Say (Hall, 1989). The need to understand how a crashed economy operates necessitated the adoption of Keynesian model that was more sensitive to developing short-term solutions to challenges in the economy.

Another reason classical model of explaining and formulating economic policies was left as that it claims that only individual hardship can result from a market. They believe that only an individual seller may suffer if there is a drop in the demand levels. These theorists argued that such hardships are only temporary and can be overcome by the individual adjusting his/her skills to the standards of the market needs. Nevertheless, classical economists failed to recognize the fact that economic failure may be general and far-fetched beyond individual failure. The theory, therefore, became rather paradoxical than practical. They insisted that there is no possibility of realizing overall market failure. In practice, the economy suffered greatly from economic depression that saw a general economic decline. Classical theory became inconsistent and could no longer be relied on in formulating economic policies. During the times of Economic Depression, systematic failure was experienced frustrating individuals even when they make right decisions on the types of goods they bring to the markets. During these times, a policy advocated by the classical economists that producing goods that are demanded would sustain individual competence failed to operate hence the preference to the Keynesian model.

The implication of classical liberalism on employment that aggregate supply can generate its own demand failed to remain operational. According to classical liberalism, a market remains stable and will always drive the economy towards attaining an economic equilibrium with the highest degree of employment. In long term understanding, the view may be practical but not sustainable. Keynes thus shade light on the fact that there are various rigidities that find their way into the market due to the producers lowering the business confidence and render private economy unstable with stagnations and an ultimately high levels of unemployment (Hall, 1989).

Keynes view of the economy made it palpable that some situations call for government intervention especially in the private economy to moderate fluctuations and restore full employment. Policymakers afterwards overwhelmingly adopted the Keynes' theory that government intervention in the economy is irresistible. In fact, after 1936, economic policy makers began to realize that indeed the government has a responsibility to regularly intervene in the operations of the economy.

The postwar period made Keynes theory inevitable. Policymakers began to argue from around 1930s that there should be a willingness to accept a rise in the public sector deficit so as to finance public works or other spending programs in order to lower unemployment. Keynesian principles, therefore, began to transform the understanding of scholars and policy makers as there grew the need to cope with the challenges of the postwar economy. In fact, intellectual environment and economics took a new school of thought based on Keynesian economic model. Keynesian model became widely accepted because it provides a framework for economic policy formulation that offers

immediate solutions economic recessions and depressions. It recognizes the fact that individuals do not have the resources for creating an immediate consumer spending as advocated by the classical liberals. The government, therefore, through monetary or fiscal policies can provide instant economic outcomes to end economic downturns.

### **The view of the State and Economy by the Classical Liberal**

The term political economy was first used by Classical economists of the 18th and 19th century. In the view of the classical liberals, there is a change in the relationship between political life and satisfaction of private wants. In their argument of, a society organizes itself and grows according to its own laws and processes. They perceived a change in focus from politics to the understanding of forces that mold the political society (Caporaso, 1992).

Among the earliest classical liberals such as Adam Smith, a civilized society would be realized due to the profit-driven behavior not from any deliberate plans and efforts stemming from the political process public authority.

Adam Smith, for example, preempted that there would a transformation from the savage state of man to civilized society based on capitalism. Together with other classical economists, civilization cannot be a result of intended purpose taken by the authority for private intentions. They did a lot in trying to redefine civil life free of politics. They demoted politics to and elevated nonpolitical part of civil life. As such, classical liberal economists argue that a political economy is all about the satisfaction of private wants as decided by private agents. Society is thus a nonpolitical entity. Their policies, therefore, are based on the understanding that a society should operate like a civil

society, market economy, bourgeois society or capitalism.

Under civil society view, classical economists define production to be bound to subsistence within family levels. Division of labor is predominantly the key aspect in the production in civil society. The argument is to attain a self-regulating market economy where forces of nature operate in ensuring equilibrium. They argue that if market can satisfy private needs of its participants through the available means of attaining the satisfaction, then it is described to have attained ipso facto accomplished its human and society purpose. They believe that interest rate flexibility, wage adjustment rates and price flexibility are sufficient tools for controlling unemployment.

## **Economic Performance under Classical Model**

While Classical theory was widely embraced in the U. S between 1870s and 1930s, the economy registered dismal performance in terms of GDP leading to a stock crash from 1929. The GDP declined by over 29%. Notably, the classical model became irrelevant and could not provide a response to the economic declines during the times of Spanish American War from 1900 and later on the First World War both of which caused devastating consequences on the economy (Eisner, 2013). It was noted during recession that, inflation levels rose abnormally while the GDP declined significantly. The market forces that were advocated under classical model became unable to provide solutions to the challenges. In fact, the rates of unemployment also increased significantly to 29 percent while work productivity also went down. For instance, during the economic depressions experienced during the 1930s, productive capacity existed to be used in producing goods that

people wanted yet it could not be exploited. The workers were there to set productive capacity to the standard they hoped but fact that they were not employed incapacitated them.

## **Keynesian View of State and Economy**

Keynes published his theory of economy in 1936 in response to the challenges that had hit the economy since from 1930s following the failure of the classical liberal model to provide a solution to the problems. The arguments of Keynes were contrary to what the classical economists advocated for. In Keynesian theory, economy operates as directed by the prevailing demand rather than the argument that supply sets its own demand. Businesses should base their production decision as controlled by the anticipated demand not the vice versa. In other words, the more the consumers are willing and ready to spend their disposable income, the more the output levels should be to meet the expected demands.

According to Keynesian economic theory, supply should be in response to the demands. For an economy to attain full employment, the total spending in the economy needs to be adequate. Keynes model is against the connotation by the classical economies that market economies can automatically attain full employment. The critical determinants of full employment according to Keynesian theory are demand and total spending. If the spending levels is adequate, full employment is likely to be realized, otherwise, unemployment results. In view of the Keynes, wage flexibility is impossible to attain the real world. There are a number of forces that operate in an economy that make it unrealistic to have a drastic adjustment

in the wage rates as advocated by the classical counterparts. The central government has a responsibility to manage aggregate demand levels because the economy cannot be relied on to automatically maintain full employment. Keynesian policies, therefore, encourage government participation in the economy through fiscal policies, taxation and spending. In the event that unemployment exists the government needs to increase its spending on goods and services without increasing tax levels. Doing so will help in shifting the demand rightwards to restore equilibrium. Consequently, GDP and employment becomes adjusted as well.

## **Economic performance under Keynesian Model**

Since its adoption in the 1930s following the failure of the classical economic model, Keynesian policies helped in restoring economic instability. For instance, the GDP levels began to experience a gradual improvement of 3.2% annually while the unemployment levels went down from the 29% to about 17% due to the policies that Roosevelt adopted based on Keynesian model after Economic Recession. Labor productivity also registered notable improvements.

Conclusions

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