

Evaluate the different schools of thought that exist with regard to stabilisation...



Evaluate the different schools of thought that exist with regard to stabilization of business cycles

Inserts His/Her InsertsGrade Course Customer Inserts Tutor's Name (25, July, 2011) Business cycle is a pattern of repetitive fluctuations in the economic growth of a country. These fluctuations are caused by the differences which occur in the GDP (gross domestic product), employment rate, rate of interest and other economic factors. There are three different schools of thoughts which are related to the stabilization of the business cycle. (1) Self-correcting mechanism (2) Keynesian theory of business cycles (3) Real business cycle theory. The self-correcting mechanism states that if any of the major economic problems (inefficiency, slow growth, instability etc.) would occur in the economy then the mechanisms of "self interest" and "invisible hand" will rectify these problems. The self-correcting mechanism was proposed by Adam Smith. He suggested that in any such condition the forces of demand and supply will work automatically and the equilibrium will be restored by self correcting mechanism. But when the self-correcting mechanism failed badly due to problems such as inflation and unemployment, John Maynard Keynes, the founder of macro economics, disagreed with the phenomenon of self-correcting mechanism. In his theory he has focused on the role of government and the aggregate demand. J. M. Keynes has suggested that the higher the level of the aggregate demand, the higher will be the level of employment, supply and economy. In his theory he has discussed the demand side of the business cycle. He suggested that whenever there is a downfall in the economy the government should increase the aggregate demand through economic policies (fiscal and monetary) and through increase in investment expenditure. According to him a raise in aggregate

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demand will result in growth in supply, employment, income and economy. In other words the Keynesian theory of business cycle states that by implementing expansionary fiscal policies the government can raise aggregate demand and in return it will give a boost to economy. The real business cycle theory was initiated by Prescott. It defines that the fluctuations in business cycle occur due to reasons other than demand and supply. The major causes of these fluctuations are wars, natural disasters, change in technology etc. Therefore instead of applying short term policies such as fiscal and monetary policies the government should design a long term policy in order to stabilize the business cycle and to restore the economy. According to this theory the government should make use of advance technology and should take initiatives through which it can handle unexpected natural disasters. All these concepts put forward various ways of stabilizing the economy and business cycle. The reason behind the differences in these schools of thoughts is that different economists have different perspectives regarding different issues and they design their theories according to their perspectives. Bibliography Investor Words., n. d., Business Cycle. Viewed July 25, 2011. < http://www.investorwords.com/625/business_cycle.html> Information Bible., 2011., Keynesian Theory Of Business Cycles. Viewed July 25, 2011.