Keynesian theory

[Economics](), [Macroeconomics]()

Why do Keynesian economists believe market forces do not automatically adjust for unemployment and inflation? What is their solution for stabilizing economic fluctuations? Why do they believe changes in government spending affect the economy differently than changes in income taxes? Classical economists offered a solution to end unemployment during the 1930s Great Depression. These economists stated that wages were too high; meaning the employed were being paid too much for their work. Classical economists argued that if the government were to decrease wages then unemployment would fall and as such the Depression would end. Keynesian economists have a different theory. Keynesian economists believe the government should institute control and make decisions about the economy in order to manipulate market forces. Keynesian economists argue that wages adjusted to price levels in the market which advertently changed the way in which money was spent and decreased investment demand. When people have less money to invest, they are more likely to save that money. When people save money, they are not spending money. Production levels go down because there is no one to buy goods and services. This cycle puts the economy into a recession. Keynesian economics gave a solution to this problem through aggregate demand management. Keynesian economists believe that to pull an economy out of a rut, the entire population must contribute. Under the aggregate demand management theory, governments take control of the aggregate level of spending by encouraging spending. To do this, the government must create incentives for the population to spend money, such as tax rebates, lower interest rates, and reward systems. Changes in government spending can affect the economy differently than changes from income taxes. This can be seen in the income effect and the purchasing power of individuals. When goods or services have decreases in prices, a previously set amount of money can purchase more of these goods and services. This means that demand will increase. When income taxes are lowered, the aggregate demand is stimulated because as in the example above individuals have been motivated to buy. Government spending or investment is another way in which the government stimulates the economy. When the government promotes individual spending through government spending, the aggregate demand is also stimulated; however, government spending stimulates the economy on a much larger scale. Colander, D. C. (2010). Macroeconomics (8th ed.). Boston, MA: McGraw-Hill/Irwin