Keynesian vs monetarist economy

Economics

Humanity has known in its history long periods of growth with the Agrarian Revolution, the Industrial Revolution, the Oil era and now the Information's one. From the last period of sustained growth is born the myth of continuous and eternal growth. However, the scarcity of natural resources and the awareness of the negative effects of economic activities suggest that humanity may live a long period of stagnation. In fact, it has already experienced long periods of recession.

That is the reason why we should prepare ourselves to sustain growth rather than calling it as our ancestors called rain. In order to achieve this goal, we can follow different economic philosophies such as Keynesianism or Monetarist economies. In this work, we will focus more on Keynesianism. Firstly, we will discover the history of this theory and then define it. In addition, we will analyse and describe all the components of this theory. Finally, we will be comparing the two approaches to demonstrate that Keynesianism is much more effective and brings more advantages than Monetarists.

John Maynard Keynes was born in England in 1883 until his death in April 1946. Keynes was certainly the greatest economist of the twentieth century (Clark, 2008). Even today he returns often in the foreground: the known subprime financial crisis in late 2009 led a great business newspaper to elect him " Man of the Year" (Diever, 2010). Keynes' thinking was very different from the others, this is the main reason his thoughts were terribly combated by anti-Keynesian. However it is still standing until our day while periods of economic crisis have put his theory in the spotlight again (Diever, 2010).

Because it was not only an economist but also a philosopher, mathematician, man of letters, arts andculture, John Maynard Keynes was able to equal in the previous century Karl Marx, Francois Quesnay in the eighteenth or William Petty in the seventeenth. He managed to dominate the economics of his time, knead it, model it, then transformed and enhanced it in the hands of the generations following. He has been for a long time in the protective shadow of Alfred Marshall, the great apostle of market equilibrium; But once out of the traditional ideologies, he runs through his own path with an impressive force.

He wrote the book known as " The General Theory of Employment, Interest andMoney", which was published in London in 1936. It is the main work of John Maynard Keynes , The General Theory which contain 24 chapters is primarily a theory of employment. It was very well received in 1936 because it offered a plausible solution to the distressing problem of unemployment (unemployment rate of over 10% in Britain) . The general theory aims to present the operation of the economic system as a whole (also called economic circuit).

We can then say that Keynes theory is in a macro-economic level (Pettinger , 2008). The principle of his economic approach was based on a logic and circular flow of money; when the expenses increase, revenues increase as well, which will lead to more spending that will result once again for more income. This flow of money is simple to understand, and to Keynes, the key is to spend. Indeed, each person spending causes the benefit of another person; and the person who perceived the money will in her turn spend it, which will go towards the benefit of a third person, and so on ...

After the first signs of theGreat Depressionin 1929, the nature of people have led them amass their money and let him sleep for fear of being in need. This has lead to a decrease in spending and hence lower flow circulation. In doing so, we maintain the economy at a standstill anddepressionbursts. Following Keynes' theory, in order to overcome a critical economic situation, it is necessary for the government to intervene. In fact, his theory advocates of government financial interventions by increasing the money supply or investing in the country (Pettinger , 2008).

But unfortunately, during the Great Depression, it was not one of the most popular solutions. Keynes thought about involving the government is very different from the popular economic thought, which preceded it. Basically, Keynesianism is against the practice of excessive savings and not enough spending or consumption in an economy. Today people who are saying they are Keynesians are more or less those who are in favour of the state intervening in the economy while monetarists' aim set on providing stability to the system by controlling the money supply (DeNardo, 2008).

On one hand, Keynes provoked a revolution in economic. His theory became to be very positively received, because it could explain why during the economy of the Great Recession there was still unemployment; a fact that a basic economy could not explain. It is in this context that Keynes became very popular. In fact, previously in economics the classical argument would have been: while facing economic condition, the salary will drop as well as the cost of work, and people will automatically get employed again. On the other hand, there are two types of Keynesians: fiscal Keynesians and monetarist Keynesians.

We believe that fiscal Keynesians are more close to the idea of Keynes, which explain that in a period of a downturn in a recession, the State can take over the investment function by investing itself like an entrepreneur (Jeremy, 2011). The most recent example of such a Keynesian approach to the economy will be the State plans of china during 2008 downturn, in which the State has really employed a lot of people to build bridges airports, roads etc… However, to be effective, the state intervention should not create more risks for the economy than it provokes benefits by employing more people.

Meaning that a State, which is already in debt, will not be advised to use such an approach. It will create such a negative outlook for the fiscal side of the economy (Pettinger , 2008). Then the individual local entrepreneurs would stop any investments for their businesses and would definitely not invest on new projects. Indeed, the drawbacks of going more into debt to make the State an employer can very easily out ways the benefits of employing more people in a downturn (Jeremy, 2011). In Western Europe for example, they have lost this capacity of applying this type of Keynesian approach.

Most of them have more than 80 % of debt in GDP and already facing a lot of dangers in the financial market (Gerald , 2009). Nevertheless, The monetarist Keynesians type is a useful way to use Keynes theory without government spending; they have lost the fiscal ability to intervene. In fact, this type of approach calls the use of the Central Banks or the Federal Reserve (U. S. A) to buy treasury bunds from the government and print more money to increase the activity. Completely at the opposite Spectrum of

Keynesians who wants to intervene within an economy, these are called monetarists.

They believe that money is neutral, meaning that it is not because you double the amount of money in an economy that you will be producing more (Cowen, 2012). Each unit of money that you are doubled will be worth for the economy by creating the phenomenon of inflation. Thus the role of authorities is very reduced. Friedman, who is the leader of this ideology, will be advocating the stable growth in the money supply, which means that the Central Banks have to maintain a regular rate (Cowen, 2012). However, we found that Friedman's assumption is false. First, Professor M. Friedman is most famous for the following equation: MV = PT; where M equal Money, V was representative of the Volacity, P equal Prices and T represented Transactions (DeNardo, 2008). Most people think that this formula was his contribution to the monetary theory and he was very famous for this. However, during our research we discovered that many economics before Friedman used this formula. In addition to that, following his monetary theory, it is possible to control the money supply so that you can affect the performance of the economy; that the instability in the money supply is responsible for recessions and depressions.

Today, the events of the 2008 recession have proven that Friedman's assumption of controlling the money supply is a false one. Indeed, we all know that bank lending is the key to money supply. However, nowadays the banks do not trust each other, and they refuse to lend to each other. Without lending, this is clear that the money supply will decrease indefinitely. The principal consequences of this approach will be the reduction of velocity of money as people do fewer transactions.

This decrease in velocity and money supply will lead consumers to do fewer purchases and businessmen fewer investments. It was proven in the 1930s in America, which was called liquidity trap. To conclude, we can say that both economies have their advantages and disadvantages. However, the Keynesian one seems more applicable nowadays in some countries in order to overcome this recession and sustain a growth. Few decades before, it was said that most economic theories, including Monetarists, were preaching individualism, competition and non-intervention of the State.

The sovereign functions (Police, Army, Justice), the construction of public edifices, therespectof competition’s rules were their principal matters at that time. The historical reality is however different: back in the days during the Industrial Revolution, the State intervened in many countries to ensure the " takeoff" of their economy. In France, the State intervened in the development of railways and agriculture (tariffs Meline 1896). England adopted the Act Enclosures for agricultural land. The U. S. intervened in the development of the railway.

Germany established protectionist measures with Frederic List (1789-1846). Finally in Japan, during the Meiji era (1868), the State created the first companies in order to sell them to families after, “ Zaibatsus” (Gerald , 2009). Moreover, after the crisis of 1929, the New Deal was an important ideological impact in the United States with a significant change in the conception of the role of the state: the state becomes interventionnist.

(Gerald , 2009) We can consider that Keynesians' believes and thoughts were always adopted in some of the rude moments of our economic history.

Despite some difficulties, it have always brought positive results to the evolution of the economy; and we all remember John Maynard Keynes as the most remarkable economists of the history. As far as we are concerned, we strongly believe that the Keynesian theory, depiste its disadvantages, brings more benefits to the society and to people's lives. After his death, Keynes' ideas were preached by his disciples; the mistake was to carry on the same methods during the post war situation and not try to adapt these methods in order to meat with the current circumstances and avoid another recession.

REFERENCES

1. Gerald, M. (2009, 04 27). Les politiques economiques. Retrieved from http://www. skyminds. net/economie-et-sociologie/la-regulation-des-activites-sociales/les-politiques-economiques/
2. Clark, J. M. (2008, 12 09). John maynard keynes. Retrieved from http://www. newworldencyclopedia. org/entry/John_Maynard_Keynes
3. DeNardo, G. (2008, 12 07). Mv= pt a classic equation and monetary policy. Retrieved from http://www. nolanchart. com/article5583-mvpt-a-classic-equation-and-monetary-policy. tml
4. Cowen, T. (2012, 07 30). Business cycles explained: Monetarist theory. Retrieved from http://learnliberty. org/videos/business-cycles-explained-monetarist-theory
5. Pettinger , T. (2008, 12 30). Keynesianism vs monetarism. Retrieved from http://www. economicshelp. org/blog/1113/concepts/keynesianism-vs-monetarism/

6. Diever, M. (2010). Les principaux courants de pensee economique. Retrieved from http://www. oeconomia. net/private/cours/economiegenerale/CAPET/01. theorieseconomiques. pdf