

# Business economics essay sample

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## **Keynesian and Monetarist Policies in Macro Economy**

In the macro economy, there are policies, which are employed to control the economy of a country. The policies are the Keynesian or demand sided policies and the supply sided policy, which is also referred to as Monetarism policy. Monetarism is currently classical economics and Keynesianism is Mercantilism economic policies. These policies have various differences on how they are employed to control the economy. Keynesian school of thought claimed that the Classical thought is rigid in their assumptions in that they advocated for price flexibility and full employment, but, on the other hand, they were rigid in their advocating for fixed prices and quantity adjustments. Keynesians focuses on the economic activity and behaviors in terms of variables flow. They analyze the economy over some time. Keynesian economics is concern with the flow instability and alterations in " flow" variables. Monetarists are concern with the economic activity and behavior regarding the stock variables. They analyze the economy in a given time frame; they are concern with the response to stock instability and relative prices changes. Monetarist macroeconomic strategies are intended to manage the supply of (stock) money (Brux 2007).

Keynesians applies a short-run time concept to clarify the levels of employment and income regarding a typical business cycle. Their main concern is the temporary instability in the money supply velocity, which changes as the saving/consumption ratio varies. Velocity increases on the increase in saving/consumption ratio and velocity decline when the saving/consumption ratio declines (Higson 2011). Monetarists, on the other hand, use a long-run time lag concept to clarify the patterns and levels of

resource allocation and demand that appear after all necessary adjustments have been done. Velocity is presumed to be steady in the long run.

Monetarists main concern is the money supply temporary instability, which changes the long-run balance in saving/consumption ratio.

Keynesians consider that the prospect is not quantifiable or acknowledged in any probabilistic basis. For Keynesians, time shifts in just single direction, which is forward. Whilst the history might be recognized for certain, the prospect is not. Because money is constantly required to enter the financial and real markets, not every asset is perfect alternate for the other one.

Money is simply a perfect substitute for every other asset. Economic players will constantly keep and hold some funds for precautionary reasons (Congdon 2007). How many economic players hold the money for speculation purpose is quantify of their uncertainty about the prospect.

According to Keynesians, a monetary creation economy working with total certainty is a contradiction in terms. Keynesian theory highlights the purpose for holding money (Johal & Haslam 2000). Monetarists think that the future is sure or at least quantifiable or recognized in the probabilistic manner.

Therefore, in the Monetarist view economic players have no reason to hold funds for precautionary reasons. Every asset is a perfect alternative for one another. Monetarists consider that money should be spent. Consequently, if economic participants have some more money to spend, they will spend the same quantity, if they possess less money, they will consequently spend less. Monetarist theory highlights the purpose for spending funds (Young, Weinblatt & Arnon 2010)

Keynesians think that the populace has money illusion. They are slow to

respond to price raise and decline to reduce prices, even when prices can be declining. The existence of money illusion partially validates the stickiness of prices when demand declines, so that market changes are in the amount and not prices (Coddington 2003). Monetarists suppose that people do not have money illusion. They react very swiftly to price raise and realize the reasonableness of employing pay cuts as prices declines (Brux 2007). The nonexistence of money illusion partially validates the stickiness of the amount when demand varies, as a result, market regulations are only in prices and not the amount. Keynesians presume imperfectly aggressive markets and other inflexibility that prevent prices from altering at the same pace with the quantity. Businesses alter the quantity as compared to price in reaction to alteration in demand. Monetarists presume pure and completely competitive markets. They count on the flexibility of price and wage to allot resources and allocate productivity around the economy without causing too much unemployment or inflation (Congdon 2007).

Keynesians also suppose that that source of macroeconomic instability is the government, and private sector has the sole ability to offsetting or correcting the private sector unsteadiness. Keynesians advocates for active government participation to maintain the economy in a stability position on a noninflationary expansion path (Coddington 2003). Monetarists, on the other hand, supposed that the private section is intrinsically steady and that if left alone it will automatically adjust owing its own imbalances. Monetarists discourage government participation in the economy, but for offering traditional services such as national defense. Keynesians also measures household spending by employing consumer expenditure concept. Consumer

expenditure varies extensively from yearly, due to expenditure on durable goods. Only the definite amount used up yearly provides income, and employment to the various factors of production. Consequently, employment and GDP are unsteady from year to year, since consumer expenditure is unstable (Congdon 2007). Their counterpart, Monetarists applies consumption expenditure as the determinant of household expenditure. Consumption spending measures the utility of wealth or consumer goods over time, as opposed to per period consumer spending. Consequently, employment and income are steadier from year to year (Johal & Haslam 2000).

Keynesians do consider the income effect to have control consumption decision and consumption is principally a function of disposable current income:

$$C = f(Y_d) = C_a + (b)Y_d$$

As disposable current income adjusts, households' expenditure also changes depending on the direction of the adjustments that are if falling or rising.

Monetarists, on the other hand, consider the wealth effect as the control of consumption decisions and that consumer expenditure is chiefly a function of relative prices and wealth.

$$C/P = f(W; P_a/P_b) = (g)W/P$$

As wealth adjust, the marginal utilities of possessing diverse assets varies and makes households vend some assets and procure others till marginal utility from the final dollar used up on all assets equates. Households expenditure lies on the on whether wealth is falling or rising.

Keynesian economics has frequently been termed as "depression"

economics. Under this circumstance of depression, demand expansion is contracting. Businesses contain excess capability and their real stock of capital are by and large larger than their preferred stock of capital. Businesses are pessimistic on their future profits and markets. They tend to be insensitive to alterations in interest rates ( $0 < e_l < 1$ ), since they are just not interested in accruing more capital at this cycle stage of the business (Coddington 2003). Monetarist economics is an existing version of full employment classical economics. On full employment in the economy, demand is usually rising very swiftly. Businesses are working at their capability limitations, and their real stock of capital is normally smaller than their preferred stock of capital. Businesses prospect on the future is optimistic and sure on future of their profits and markets. They seem to be highly reactive to even minute alteration in interest rates ( $1 < e_l < \infty$ ), since they are absolutely interested in accumulating additional capital at an assured point of the cycle of business. In the liquidity of money, Keynesians consider money as liquidity par excellence. They accentuate the medium of exchange role of money. Liquidity is the easiness of exchangeability and marketability, one asset for another. Liquid assets usually do not preferably store value, but can purchase everything at any time. Monetarists consider money as a momentary abode of purchasing power (Higson 2011). They give emphasis to the expenditure power of money and the call for storage of value over time awaiting the buyers is readiness to enter the market. Keynesians advocates for all the four functions of money  $M_d = f(Y, i, \mu)$ . The money demand function in Keynesian economics is very unsteady, since uncertainty and income changes seem to dictate the position of the demand

function of money. This money demand function (MdK) of Keynesian is also taken to be very responsive to alteration in the interest rate ( $1 < e_m < \infty$ ), due to the speculative reason. At some smallest interest rate ( $i_{min}$ ), the probability of holding money balances is believed to be zero, because the interest rate is not adequate to cover up the risk and conversion transaction cost. This makes the money demand function to be perfectly elastic and hence liquidity trap in the economy. On the other hand, Monetarists think that money is required just for transactions purpose.  $M_d = f(Y)$  The transaction role is tied to income. Consequently, the money demand function in monetarist economics (MdM) is believed to be somewhat steady or predictable, and it is not extremely responsive to alteration in the interest rate ( $e_m \Rightarrow 0$ ), since it is not tied interest rates but income (Congdon 2007). In conclusion, Keynesians think that the supply and demand of money are interdependent. They presume that supply of money is determined partially exogenously by government and partly endogenously by the bank lending policies and demand for money. Monetarists suppose that the money supply is autonomous of the money demand. They presume that the supply of money is exogenously determined by the government and that the money demand is determined by individuals' preferences and tastes (Brux 2007). They also presume that, though, economic participants and private economic activity can manipulate the supply of money, the government has the capability, through employment of its policy tools, to compensate private sector instabilities to deal with the money quantity in circulation.

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