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Previously, classical economic thinking held that cyclical swings in employment and economic output would be modest and self-adjusting. According to this classical theory, if aggregate demand in the economy fell, the resulting weakness in production and jobs would precipitate a decline in prices and wages. A lower level of inflation and wages would induce employers to make capital investments and employ more people, stimulating employment and restoring economic growth. The depth and severity of the Great Depression, however, severely tested this hypothesis. Keynes maintained in his seminal book, "General Theory of Employment, Interest and Money," and other works, that structural rigidities and certain characteristics of market economies would exacerbate economic weakness and cause aggregate demand to plunge further. For example, Keynesian economics refutes the notion held by some economists that lower wages can restore full employment , by arguing that employers will not add employees to produce goods that cannot be sold because demand is weak. Similarly, poor business conditions may cause companies to reduce capital investment , rather than take advantage of lower prices to invest in new plants and equipment. This would also have the effect of reducing overall expenditures and employment. The famous book was informed by directly observable economic phenomena arising during the Great Depression, which could not be explained by classical economic theory. In classical economy theory, it is assumed that output and prices will eventually return to a state of equilibrium , but the Great Depression seemed to counter this assumption. Output was low and unemployment remained high during this time. The Great Depression inspired Keynes to think differently about the nature of the economy. From these theories, he established real-world applications that could have implications for a society in economic crisis. Keynes rejected the idea that the economy would return to a natural state of equilibrium. Instead, he envisaged economies as being constantly in flux, both contracting and expanding. This natural cycle is referred to as boom and bust. In response to this, Keynes advocated a countercyclical fiscal policy in which, during the boom periods, the government ought to increase taxes or cut spending, and during periods of economic woe, the government should undertake deficit spending. Keynes was highly critical of the British government at the time. The government cut welfare spending and raised taxes to balance the national books. Keynes said this would not encourage people to spend their money, thereby leaving the economy unstimulated and unable to recover and return to a successful state. Instead, he proposed that the government spend more money, which would increase consumer demand in the economy. This would in turn lead to an increase in overall economic activity, the natural result of which would be deflation and a reduction in unemployment. Keynes also criticized the idea of excessive saving, unless it was for a specific purpose such as retirement or education. He saw it as dangerous for the economy because the more money sitting stagnant, the less money in the economy stimulating growth. These two schools of thought assume that the market is self-regulating and natural forces will inevitably return it to a state of equilibrium. On the other hand, Keynes, who was writing while mired in a period of deep economic depression, was not as optimistic about the natural equilibrium of the market. He believed the government was in a better position than market forces when it came to creating a robust economy. Keynesian Economics and the Multiplier Effect The multiplier effec t is one of the chief components of Keynesian economic models. This theory proposes that spending boosts aggregate output and generates more income. If workers are willing to spend their extra income, the resulting growth in gross domestic product GDP could be even greater than the initial stimulus amount. The magnitude of the Keynesian multiplier is directly related to the marginal propensity to consume. Its concept is simple: Spending from one consumer becomes income for another worker. Keynes and his followers believed individuals should save less and spend more, raising their marginal propensity to consume , to effect full employment and economic growth. In this way, one dollar spent in fiscal stimulus eventually creates more than one dollar in growth. This appeared to be a coup for government economists, who could provide justification for politically popular spending projects on a national scale. This theory was the dominant paradigm in academic economics for decades. Eventually, other economists, such as Milton Friedman and Murray Rothbard , showed that the Keynesian model misrepresented the relationship between savings, investment and economic growth. Many economists still rely on multiplier-generated models, although most acknowledge that fiscal stimulus is far less effective than the original multiplier model suggests. The fiscal multiplier commonly associated with Keynesian theory is one of two broad multipliers in macroeconomics. The other multiplier is known as the money multiplier. This multiplier refers to the money-creation process that results from a system of fractional reserve banking. The money multiplier is less controversial than its Keynesian fiscal counterpart. Keynesian Economics and Interest Rates Keynesian economics focuses on demand-side solutions to recessionary periods. The intervention of government in economic processes is an important part of the Keynesian arsenal for battling unemployment, underemployment and low economic demand. The emphasis on direct government intervention in the economy places Keynesian theorists at odds with those who argue for limited government involvement in the markets. Lowering interest rates is one way governments can meaningfully intervene in economic systems, thereby generating active economic demand. Keynesian theorists argue that economies do not stabilize themselves very quickly and require active intervention that boosts short-term demand in the economy. Wages and employment, they argue, are slower to respond to the needs of the market and require governmental intervention to stay on track. Prices also do not react quickly, and only gradually change when monetary policy interventions are made. This slow change in prices, then, makes it possible to use money supply as a tool and change interest rates to encourage borrowing and lending. Short-term demand increases initiated by the government reinvigorate the economic system and restore employment and demand for services. The new economic activity feeds a circular, cyclical growth that maintains continued growth and employment. Without intervention, Keynesian theorists believe, this cycle is disrupted and market growth becomes more unstable and prone to excessive fluctuation. Keeping interest rates low is an attempt to stimulate the economic cycle by encouraging businesses and individuals to borrow more money. When borrowing is encouraged, businesses and individuals often increase their spending. This new spending stimulates the economy. Lowering interest rates, however, does not always lead directly to economic improvement. Keynesian economists focus on lower interest rates as a solution to economic woes, but they generally try to avoid the zero-bound problem. As interest rates approach zero, stimulating the economy by lowering interest rates becomes more difficult. Interest rate manipulation may no longer be enough to generate new economic activity, and the attempt at generating economic recovery may stall completely. The lower boundary of interest rates, then, is not necessarily an aspiration of Keynesian economists, but is rather a means to an end. When this method fails to deliver results, other strategies must be appropriated. Other interventionist policies include direct control of the labor supply, changing tax rates to increase or decrease the money supply indirectly, changing monetary policy, or placing controls on the supply of goods and services until employment and demand are restored. Keynesian theorists believe in interventionist methods, but are occasionally forced to look beyond interest rates.

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The talks were delivered as part of roundtable discussion on John Maynard Keynes of Bloomsbury, the inaugural event of the Center for the History of Political Economy at Duke University, and were.

John Maynard Keynes was born in Cambridge , Cambridgeshire , England , to an upper-middle-class family. His father, John Neville Keynes , was an economist and a lecturer in moral sciences at the University of Cambridge and his mother Florence Ada Keynes a local social reformer. Keynes was the first born, and was followed by two more children â€" Margaret Neville Keynes in and Geoffrey Keynes in They remained in the same house throughout their lives, where the children were always welcome to return. Keynes would receive considerable support from his father, including expert coaching to help him pass his scholarship exams and financial help both as a young man and when his assets were nearly wiped out at the onset of Great Depression in He quickly showed a talent for arithmetic, but his health was poor leading to several long absences. He was tutored at home by a governess, Beatrice Mackintosh, and his mother. By , Keynes was top of his class and excelling at mathematics. Keynes joined the Pitt Club [19] and was an active member of the semi-secretive Cambridge Apostles society, a debating club largely reserved for the brightest students. Like many members, Keynes retained a bond to the club after graduating and continued to attend occasional meetings throughout his life. He was said to be an atheist. Aside from a few months spent on holidays with family and friends, Keynes continued to involve himself with the university over the next two years. He took part in debates, further studied philosophy and attended economics lectures informally as a graduate student for one term, which constituted his only formal education in the subject. He took civil service exams in According to Skidelsky , the sense of cultural unity current in Britain from the 19th century to the end of World War I provided a framework with which the well-educated could set various spheres of knowledge in relation to each other and to life, enabling them to confidently draw from different fields when addressing practical problems. By Keynes had published his first professional economics article in The Economic Journal, about the effect of a recent global economic downturn on India. Also in , Keynes accepted a lectureship in economics funded personally by Alfred Marshall. In Keynes was made editor of The Economic Journal. By he had published his first book, Indian Currency and Finance. His written work was published under the name "J M Keynes", though to his family and friends he was known as Maynard. His father, John Neville Keynes, was also always known by his middle name. In January , Keynes took up an official government position at the Treasury. Among his responsibilities were the design of terms of credit between Britain and its continental allies during the war, and the acquisition of scarce currencies. The secretary of the Treasury was delighted to hear Keynes had amassed enough to provide a temporary solution for the British Government. But Keynes did not hand the pesetas over, choosing instead to sell them all to break the market: He was also appointed Officer of the Belgian Order of Leopold. Keynes was initially wary of the "Welsh Wizard," preferring his rival Asquith , but was impressed with Lloyd George at Versailles; this did not prevent Keynes from painting a scathing picture of the then-prime minister in his Economic Consequences of the Peace. Unfortunately for Keynes, conservative powers in the coalition that emerged from the coupon election were able to ensure that both Keynes himself and the Treasury were largely excluded from formal high-level talks concerning reparations. Their place was taken by the Heavenly Twins â€" the judge Lord Sumner and the banker Lord Cunliffe whose nickname derived from the "astronomically" high war compensation they wanted to demand from Germany. Keynes was forced to try to exert influence mostly from behind the scenes. Lloyd George did however win some loyalty from Keynes with his actions at the Paris conference by intervening against the French to ensure the dispatch of much-needed food supplies to German civilians. Clemenceau also pushed for substantial reparations, though not as high as those proposed by the British, while on security grounds, France argued for an even more severe settlement than Britain. Wilson initially favoured relatively lenient treatment of Germany â€" he feared too harsh conditions could foment the rise of extremism, and wanted Germany to be left sufficient capital to pay for imports. Towards the end of the conference, Keynes came up with a plan that he argued would not only help Germany and other impoverished central European powers but also be good for the world economy as a whole. It involved the radical writing down of war debts, which would have had the possible effect of increasing international trade all round, but at the same time thrown the entire cost of European reconstruction on the United States. Lloyd George agreed it might be acceptable to the British electorate. However, America was against the plan; the US was then the largest creditor, and by this time Wilson had started to believe in the merits of a harsh peace and thought that his country had already made excessive sacrifices. Hence despite his best efforts, the end result of the conference was a treaty which disgusted Keynes both on moral and economic grounds, and led to his resignation from the Treasury. I cannot leave this subject as though its just treatment wholly depended either on our own pledges or on economic facts. The policy of reducing Germany to servitude for a generation, of degrading the lives of millions of human beings, and of depriving a whole nation of happiness should be abhorrent and detestable, â€”abhorrent and detestable, even if it were possible, even if it enriched ourselves, even if it did not sow the decay of the whole civilised life of Europe. Also present was striking imagery such as "year by year Germany must be kept impoverished and her children starved and crippled" along with bold predictions which were later justified by events: If we aim deliberately at the impoverishment of Central Europe, vengeance, I dare predict, will not limp. Nothing can then delay for very long that final war between the forces of Reaction and the despairing convulsions of Revolution, before which the horrors of the late German war will fade into nothing. However the historian Ruth Henig claims that "most historians of the Paris peace conference now take the view that, in economic terms, the treaty was not unduly harsh on Germany and that, while obligations and damages were inevitably much stressed in the debates at Paris to satisfy electors reading the daily newspapers, the intention was quietly to give Germany substantial help towards paying her bills, and to meet many of the German objections by amendments to the way the reparations schedule was in practice carried out". Schuker also shows that, in the years after Versailles, Keynes became an informal reparations adviser to the German government, wrote one of the major German reparation notes, and actually supported the hyperinflation on political grounds. Nevertheless, The Economic Consequences of the Peace gained Keynes international fame, even though it also caused him to be regarded as anti-establishment â€” it was not until after the outbreak of the Second World War that Keynes was offered a directorship of a major British Bank, or an acceptable offer to return to government with a formal job. However, Keynes was still able to influence government policy making through his network of contacts, his published works and by serving on government committees; this included attending high-level policy meetings as a consultant. Keynes developed the first upper-lower probabilistic interval approach to probability in chapters 15 and 17 of this book, as well as having developed the first decision weight approach with his conventional coefficient of risk and weight, c, in chapter In addition to his academic work, the s saw Keynes active as a journalist selling his work internationally and working in London as a financial consultant. In Keynes wrote an obituary for his former tutor Alfred Marshall which Joseph Schumpeter called "the most brilliant life of a man of science I have ever read. Britain suffered from high unemployment through most of the s, leading Keynes to recommend the depreciation of sterling to boost jobs by making British exports more affordable. From he was also advocating a fiscal response, where the government could create jobs by spending on public works. Keynes advised it was no longer a net benefit for countries such as Britain to participate in the gold standard , as it ran counter to the need for domestic policy autonomy. It could force countries to pursue deflationary policies at exactly the time when expansionary measures were called for to address rising unemployment. The Treasury and Bank of England were still in favour of the gold standard and in they were able to convince the then Chancellor Winston Churchill to re-establish it, which had a depressing effect on British industry. Keynes responded by writing The Economic Consequences of Mr. Churchill and continued to argue against the gold standard until Britain finally abandoned it in Keynes had begun a theoretical work to examine the relationship between unemployment, money and prices back in the s. A central idea of the work was that if the amount of money being saved exceeds the amount being invested â€” which can happen if interest rates are too high â€” then unemployment will rise. This is in part a result of people not wanting to spend too high a proportion of what employers pay out, making it difficult, in aggregate, for employers to make a profit. Another key theme of the book is the unreliability of financial indices for representing an accurate â€” or indeed meaningful â€”

indication of general shifts in purchasing power of currencies over time. He argued that the index understated the effects of changes in the costs of services and of labour. In he wrote, "We will not have any more crashes in our time. He believed that budget deficits were a good thing, a product of recessions. The Means to Prosperity contains one of the first mentions of the multiplier effect. While it was addressed chiefly to the British Government, it also contained advice for other nations affected by the global recession. A copy was sent to the newly elected President Franklin D. Roosevelt and other world leaders. The work was taken seriously by both the American and British governments, and according to Robert Skidelsky , helped pave the way for the later acceptance of Keynesian ideas, though it had little immediate practical influence. In the London Economic Conference opinions remained too diverse for a unified course of action to be agreed upon. Fighting for Freedom, â€", 28 April , C-SPAN Keynesian-like policies were adopted by Sweden and Germany, but Sweden was seen as too small to command much attention, and Keynes was deliberately silent about the successful efforts of Germany as he was dismayed by their imperialist ambitions and their treatment of Jews. The General Theory challenged the earlier neoclassical economic paradigm, which had held that provided it was unfettered by government interference, the market would naturally establish full employment equilibrium. In doing so Keynes was partly setting himself against his former teachers Marshall and Pigou. Keynes believed the classical theory was a "special case" that applied only to the particular conditions present in the 19th century, his own theory being the general one. An innovation from Keynes was the concept of price stickiness â€" the recognition that in reality workers often refuse to lower their wage demands even in cases where a classical economist might argue it is rational for them to do so. Due in part to price stickiness, it was established that the interaction of " aggregate demand " and " aggregate supply " may lead to stable unemployment equilibria â€" and in those cases, it is the state, not the market, that economies must depend on for their salvation. Caricature by David Low , The General Theory argues that demand, not supply, is the key variable governing the overall level of economic activity. Aggregate demand, which equals total un-hoarded income in a society, is defined by the sum of consumption and investment. In a state of unemployment and unused production capacity, one can only enhance employment and total income by first increasing expenditures for either consumption or investment. Without government intervention to increase expenditure, an economy can remain trapped in a low employment equilibrium â€" the demonstration of this possibility has been described as the revolutionary formal achievement of the work. It is precisely with these plants and these men that we shall afford them. Few senior American economists agreed with Keynes through most of the s. In the General Theory and later, Keynes responded to the socialists and left-wing liberals who argued, especially during the Great Depression of the s, that capitalism caused war. His plans during World War II for post-war international economic institutions and policies which contributed to the creation at Bretton Woods of the International Monetary Fund and the World Bank , and later to the creation of the General Agreement on Tariffs and Trade and eventually the World Trade Organization were aimed to give effect to this vision. Compulsory saving would act to dampen domestic demand, assist in channelling additional output towards the war efforts, would be fairer than punitive taxation and would have the advantage of helping to avoid a post war slump by boosting demand once workers were allowed to withdraw their savings. In September he was proposed to fill a vacancy in the Court of Directors of the Bank of England , and subsequently carried out a full term from the following April. The Keynes-plan, concerning an international clearing-union, argued for a radical system for the management of currencies. He proposed the creation of a common world unit of currency, the bancor , and new global institutions â€" a world central bank and the International Clearing Union. Keynes envisaged these institutions managing an international trade and payments system with strong incentives for countries to avoid substantial trade deficits or surpluses. According to US economist J. Bradford DeLong , on almost every point where he was overruled by the Americans, Keynes was later proved correct by events. There would be no incentives for states to avoid a large trade surplus ; instead, the burden for correcting a trade imbalance would continue to fall only on the deficit countries, which Keynes had argued were least able to address the problem without inflicting economic hardship on their populations. Yet, Keynes was still pleased when accepting the final agreement, saying that if the institutions stayed true to their founding principles, "the brotherhood of man will have become more than a phrase. He succeeded in obtaining preferential terms from the United States for new and outstanding debts to facilitate the rebuilding of the British economy. Keynesian Revolution From the end of the Great Depression to the mids, Keynes provided the main inspiration for economic policy makers in Europe, America and much of the rest of the world. According to the economist John Kenneth Galbraith then a US government official charged with controlling inflation , in the rebound of the economy from wartime spending, "one could not have had a better demonstration of the Keynesian ideas.

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The central tenet of this school of thought is that government intervention can stabilize the economy Just how important is money? Few would deny that it plays a key role in the economy. British economist John Maynard Keynes spearheaded a revolution in economic thinking that overturned the then-prevailing idea that free markets would automatically provide full employmentâ€”that is, that everyone who wanted a job would have one as long as workers were flexible in their wage demands see box. Keynes further asserted that free markets have no self-balancing mechanisms that lead to full employment. Keynesian economists justify government intervention through public policies that aim to achieve full employment and price stability. The revolutionary idea Keynes argued that inadequate overall demand could lead to prolonged periods of high unemployment. Any increase in demand has to come from one of these four components. But during a recession, strong forces often dampen demand as spending goes down. For example, during economic downturns uncertainty often erodes consumer confidence, causing them to reduce their spending, especially on discretionary purchases like a house or a car. This reduction in spending by consumers can result in less investment spending by businesses, as firms respond to weakened demand for their products. This puts the task of increasing output on the shoulders of the government. According to Keynesian economics, state intervention is necessary to moderate the booms and busts in economic activity, otherwise known as the business cycle. There are three principal tenets in the Keynesian description of how the economy works: Private sector decisions can sometimes lead to adverse macroeconomic outcomes, such as reduction in consumer spending during a recession. These market failures sometimes call for active policies by the government, such as a fiscal stimulus package explained below. Therefore, Keynesian economics supports a mixed economy guided mainly by the private sector but partly operated by the government. Keynesians believe that, because prices are somewhat rigid, fluctuations in any component of spendingâ€”consumption, investment, or government expendituresâ€”cause output to change. If government spending increases, for example, and all other spending components remain constant, then output will increase. Keynesian models of economic activity also include a multiplier effect; that is, output changes by some multiple of the increase or decrease in spending that caused the change. If the fiscal multiplier is greater than one, then a one dollar increase in government spending would result in an increase in output greater than one dollar. Keynes the master Keynesian economics gets its name, theories, and principles from British economist John Maynard Keynes â€” , who is regarded as the founder of modern macroeconomics. But its precursor, A Treatise on Money, is often regarded as more important to economic thought. Until then economics analyzed only static conditionsâ€”essentially doing detailed examination of a snapshot of a rapidly moving process. Keynes, in Treatise, created a dynamic approach that converted economics into a study of the flow of incomes and expenditures. He opened up new vistas for economic analysis. He remembered the lessons from Versailles and from the Great Depression, when he led the British delegation at the Bretton Woods conferenceâ€”which set down rules to ensure the stability of the international financial system and facilitated the rebuilding of nations devastated by World War II. Stabilizing the economy No policy prescriptions follow from these three tenets alone. What distinguishes Keynesians from other economists is their belief in activist policies to reduce the amplitude of the business cycle, which they rank among the most important of all economic problems. Rather than seeing unbalanced government budgets as wrong, Keynes advocated so-called countercyclical fiscal policies that act against the direction of the business cycle. For example, Keynesian economists would advocate deficit spending on labor-intensive infrastructure projects to stimulate employment and stabilize wages during economic downturns. They would raise taxes to cool the economy and prevent inflation when there is abundant demand-side growth. Monetary policy could also be used to stimulate the economyâ€”for example, by reducing interest rates to encourage investment. The exception occurs during a liquidity trap, when increases in the money stock fail to lower interest rates and, therefore, do not boost output and employment. In fact, they believe that governments cannot know enough to fine-tune successfully. Keynesianism evolves Even though his ideas were widely accepted while Keynes was alive, they were also scrutinized and contested by several contemporary thinkers. Particularly noteworthy were his arguments with the Austrian School of Economics, whose adherents believed that recessions and booms are a part of the natural order and that government intervention only worsens the recovery process. Members of the monetarist school also maintained that money can have an effect on output in the short run but believed that in the long run, expansionary monetary policy leads to inflation only. Keynesian economists largely adopted these critiques, adding to the original theory a better integration of the short and the long run and an understanding of the long-run neutrality of moneyâ€"the idea that a change in the stock of money affects only nominal variables in the economy, such as prices and wages, and has no effect on real variables, like employment and output. Both Keynesians and monetarists came under scrutiny with the rise of the new classical school during the mids. The new classical school asserted that policymakers are ineffective because individual market participants can anticipate the changes from a policy and act in advance to counteract them. A new generation of Keynesians that arose in the s and s argued that even though individuals can anticipate correctly, aggregate markets may not clear instantaneously; therefore, fiscal policy can still be effective in the short run. The global financial crisis of â€"08 caused a resurgence in Keynesian thought. It was the theoretical underpinnings of economic policies in response to the crisis by many governments, including in the United States and the United Kingdom. As the global recession was unfurling in late , Harvard professor N. Although Keynes died more than a half-century ago, his diagnosis of recessions and depressions remains the foundation of modern macroeconomics. Keynesian economists are rectifying that omission by integrating the real and financial sectors of the economy.

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John Maynard Keynes was born in Cambridge, Cambridgeshire, England, to an upper-middle-class racedaydvl.com father, John Neville Keynes, was an economist and a lecturer in moral sciences at the University of Cambridge and his mother Florence Ada Keynes a local social reformer.