Keynesian Economic Policy

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Keynesian economics is an **economic theory of total spending** in the economy and its effects on output and inflation. Keynesian economics was developed by the **British economist John Maynard Keynes during the 1930s in an attempt to understand the Great Depression.**

Features of Keynesian Economic Policy

- Keynesian economics refers to the concept that optimal economic performance could be achieved, and economic slumps prevented by **influencing aggregate demand through activist stabilization and economic intervention policies** by the government.
- It is highly **critical of classical economic arguments** that natural economic forces and incentives would be sufficient to help the economy recover.
- According to Keynesian economics, during recessions, structural rigidities and certain characteristics of market economies would exacerbate economic weakness and **cause aggregate demand to plunge further.**
- For example, Keynesian economics disputes the notion held by classical economists that lower wages can restore full employment during economic slump, by arguing that employers will not add employees to produce goods that cannot be sold because demand is weak.
- **Activist fiscal and monetary policy (lower interest rates)** are the primary tools recommended by Keynesian economists to manage the economy and fight unemployment.
- Keynes advocated a **countercyclical fiscal policy** in which, during periods of economic woe, the government should undertake **deficit spending** to make up for the decline in investment and boost consumer spending in order to stabilize aggregate demand.
- For example, Keynesian economists would advocate deficit

spending on **labor-intensive infrastructure projects to stimulate employment** and stabilize wages during economic downturns.

- The **multiplier effect** is one of the chief components of Keynesian countercyclical fiscal policy. According to Keynes's theory of fiscal stimulus, an injection of government spending eventually leads to **added business activity and even more spending.**
- The magnitude of the Keynesian multiplier is directly related to the **marginal propensity to consume.** One rupee spent in fiscal stimulus eventually creates more than one rupee in growth.