Student

Date

Introduction

After World War II, the US became one of the two dominating superpowers having an influence

of global capacity in military, technological, economic, cultural and political affairs. It experienced prosperity in many of its sectors (Ábel, 2019). It was seen to gain economic

prosperity and educational prosperity. However even with all these positive happenings, it is not to say that the US was exactly perfect. It also experienced some negativity such as women being forced to go back to their primary duties of being stay at home wives and also, most Americans, mostly the old and African Americans, having to live in continued poverty and disenfranchisement all through the 1950s. Additionally, even after World War II, discrimination to voting still continued to exist even though the two reigning parties had vowed to progress in 1948 (Dunn, 2021).

To start with, economic prosperity was faced in the start of the 1950s. At this time the people of middle-class living were starting to highly prefer the consumer goods, employees were enjoying increased salaries, bigger houses, improved education, and increased number of cars and technology in their houses (Galvin and Healy, 2020). After the war, economists saw Keynesianism as a useful tool in reducing unemployment and inflation. This provoked a theoretical war between liberals and conservatives that continues to this day, although Keynesianism seems to have survived a conservative disruption and a dominant ideology has emerged in the economy (Green, 2020).

Keynesian Economics

Keynesian economics, also known as fiscal policy, was a concept theorized by British economist

John Maynard Keynes. Keynes stated in his book, “The General Theory of Employment, Interest and Money”, that he was a strong proponent of increasing government spending and lowering taxes, arguing that an economy needed “aggregate demand” constantly increasing in order to be successful (Igwe, 2018). Keynes’ reasoning for his theories specifically came about when the American stock market crashed in October 1929, causing millions of people to lose their investments (Ikenberry, 2019). Because of this economic downturn popularly known as the Great Depression, “consumer spending and investment fell, resulting in sharp drops in industrial production and employment as faltering businesses lay off workers." By the early 1930s, more than 15 million Americans were without a job. During this crisis, President Herbert Hoover (1929-1933), advocated against the ideas of Keynesian Economics, stating that the government should not intervene in order to improve the economy (Mouré, 2020).

Negative Perspective On the Keynesian Model

Figure 1 “The Keynesian AD/AS Model” Keynes's view of the “AD / AS model” shows that with horizontal aggregate supply, a reduction in demand leads to a fall in productivity, but prices do not fall. Keynes believes wage agreements are not yet in place - they could be improved (Ábel, 2019). Keynes believes the economy will continue to decline and longterm unemployment. Similarly, as “aggregate demand” increases, there may be an inflation gap in the economy and demand will seek to stimulate potential growth as a result, the economy suffers from inflation.

An important policy indicator in any situation is that governments need to get involved and close the gap, increase spending during the recession and reduce spending during the boom in order to monitor potential output to restore “aggregate demand” (Dunn, 2021). As “aggregate demand” is the total cost of domestic goods and services in the economy, economists also call it fixed costs.

Total demand can be calculated by combining four components: “expenditure”, “investment expenditure”, “government expenditure” and “net export expenditure” – (exports minus imports).

“Consumption Expenditure” Consumption expenditure is

spending by households and individuals on “durable goods”, “nondurable goods” and “services”. “Durable products” are items that are durable and add value over time, such as cars. “Non-durable goods” are the luxury items, and groceries whereas the “services” are intangible goods that consumers buy, such as healthcare or entertainment (Galvin and Healy, 2020).

Keynes pointed to three factors that affect consumption:

- “Disposable Income”: For most people, the most influential determinant of how much they consume is actually the amount of income they have in their take-home pay. This calculation leads to leftover income that is also referred to as “disposable income”, which is earnings after taxes.

- “Expected Future Income”: Consumer expectations about future income are also important when deciding on costs. When consumers are confident about the future, they are more likely to use and increase “aggregate demand”. News of the recession and the economic crisis is holding them back.

- “Wealth or Credit”: As a family's wealth grows, people may be willing to spend more and reduce their savings. For example, despite the sharp rise in the U.S. stock market in the late 1990s, the price of U.S. savings fell in part because people felt that their wealth

had grown and they had little to save. When people see their wealth grow, and there was less need to save, so they started borrowing. On the other hand, the US stock market fell by almost 40% between March 2008 and March 2009, and people were very uncertain about the economic outlook, leading to an increase in the savings rate as the economy declined (Green, 2020).

Finally, Keynes noted that many other factors together determine how much people consume. As household saving conditions change to encourage consumption rather than saving, “aggregate demand” shifts to the right.

“Investment Expenditure”

Spending money on new assets is called capital expenditure. Investments fall into four categories: producer’s durable equipment and software, new non-residential structures, changes in inventories, and residential structures, manufacturers and reliable software equipment, new non-residential premises, changes in inventories and housing (Igwe, 2018). Companies that make the first three types of investments and the last type is conducted by households.

Keynes Investment Management emphasizes the key role of future expectations in influencing business decisions. When an entity decides to invest in tangible assets (such as facilities or equipment) or intangible assets (such as skills or R&D projects), the entity will consider the expected return on investment (such as future returns) and the investment costs (such as interest).

A clear driver of expected return on investment for future returns. To prevent economic growth, companies see the market for their products continue to grow. Their strong confidence in the company encourages further investment. For example, the US investment ratio increased from 18% of GDP in 1994 to 21% in 2000 in the second half of the 1990s. However, when the recession began in 2001, the US investment ratio fell sharply to 18% of GDP in 2002 (Ikenberry, 2019). The expected return on investment can be affected by many factors as Keynes believes that corporate investment is very different in all areas of “aggregate demand”.

“Government Spending”

The third component of "aggregate demand" is "federal", "state" and "local government" expenditure. Although the United States is widely regarded as a market economy, the government continues to be a major player in the economy. The government provides important public services such as "national security", "transport infrastructure" and "education". Keynes believes that the national budget is a powerful tool for influencing collective demand (Mouré, 2020). Not only does this encourage government to increase or decrease public spending, but lower or higher taxes can affect spending and investment. Keynes concluded that in a worst-case scenario, only a government would have the capacity and resources to meet “aggregate demand” in a deep recession (Palley, 2018).

“Net Exports”

Exports are products that produce domestically and are exported locally, while imports are produced abroad but supply locally. Since “aggregate demand” is defined as expenditure on domestic goods and services, export costs are added to “aggregate demand” and import costs are deducted from “aggregate demand” (Rotondi, 2019).

Exports and imports can also be affected by commodity prices in domestic and foreign markets. If US products are cheaper than those made elsewhere, perhaps because a group of US producers has been successful in producing some products, which allow US exports to may increase. If US products become relatively expensive, perhaps because the exchange rate of the US dollar and other currencies increases the value of US imports, US producers' exports could fall (Smith, 2020).

From the point of view of the Keynesian economy, the emphasis on “aggregate demand” is seen as boosting growth and thus generating its overall benefits or real impact. Designing the right public policies to manage universal needs is the key to real success, jobs and economic success. "Keynes believes that capitalism is a good system, but sometimes it needs help. When the time is right, people work, make money and use it for what they want. Spending is reviving the economy and everything is fine (Green, 2020). If this fails, demand will fall, leading to redundancies and rising unemployment. If people stop spending money because they can't find a way to survive, the economy will weaken and continue, leading to a recession.

Positive Perspective On the Keynesian Model

Keynes idea of involving the government in the control of the economy led to the establishment of the administration to help revive the American industry, improve public welfare and create job opportunities (Palley, 2018). President Roosevelt commissioned the program to stimulate economic growth through constructions of airports, roads, electricity-generating dams, schools, and hospitals. This idea was based on Keynes proposition of government expenditure that helps the economy grow and adjusts the market economy without relying on forces of demand and supply (Rotondi, 2019). The impacts of the Keynesian economy were felt in the U.S since the great depression of the 1930s, the inflation crisis in the 1970s and the mortgage crisis in 2008 (Smith, 2020). According to Keynesian economics, government interventions are necessary during economic turmoil and crisis to help achieve full employment. The government has a role in bridging the gap between the nation's economic potential and the actual output by inducing government expenditure from reserves or borrowing (Rotondi, 2019). "Aggregate supply" refers to the total expected sales in an economy over a certain duration: when drawn it represents a comparison between real production and the price level (Palley, 2018). Keynesian aggregate supply curve has segments: one segment is rather horizontal indicating that along the line prices are rigid resulting in reduced real production, the second segment is rather vertical. The vertical side represents full employment which results from limited production and fixed total quantities of resources (Mouré, 2020).

Figure 2 "Demand and Supply Equilibrium"

The issue of ensuring a balance between "aggregate demand" and potential "aggregate supply" can be seen as an inevitable result of the decentralization of the public financial system, although some of these problems can be mitigated by appropriate policies and institutional plans (Ikenberry, 2019). There are benefits to the existence of currencies and exchanges, but there are also inevitable costs that are caused by coordination failures in a decentralized economy (Igwe, 2018) and, more importantly, by the existence and uncertainty of liquidity preferences. to avoid coordinating "aggregate demand" and "aggregate supply" with full employment (Green, 2020).

During the Great Depression, full-time employment became a poor commodity in a market economy, indicating that the probability of unemployment is high (Galvin and Healy, 2020). However, the Keynesian economy allows the region to generate profits that support and encourage sustainable investment; tends to attract skilled workers from other regions; uses static and dynamic economies of scale (Dunn, 2021). Full employment in richer regions and unemployment in less rich regions coexist. The overall stimulus in demand leads to insufficient production capacity, skills shortages and inflationary pressures in richer regions, as well as unemployment in less-richer regions (Ábel, 2019).

Conclusion

Outlining the conclusion, the study demonstrated the significance of Keynesian Model and display the impact of Keynes economic policies on the reconstruction of the US after WW2. It presented the detailed overview on the negative and positive perspectives regarding Keynesian Model and how it plays a valuable role in the dynamics of great depression, especially for US.

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