**CHAPTER FOUR**

**4. THE KEYNESIAN ECONOMICS**

**4.1JOHN MAYNARD KEYNES (1883 -1946)**

John Maynard Keynes was the son of a Cambridge economist, John Neville Keynes, who was also a logician of some repute.e hehHe took his first degree in Mathematics from King’s College, Cambridge (England). His university interests were wide, covering politics (he became president of the University Liberal Club), philosophy, drama, literature and art. After taking his degree in mathematics, he studied economics under Marshall and Pigou and entered the Civil Service, being assigned to the India Office.

I shall argue that the postulates of the classical theory are applicable to a special case only and not to the general case....Moreover,the characteristics of the special case assumed by the classical theory happen not to be those of the economic society in which we actually live,with the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience. — John Maynard Keynes,The General Theory

* Two years later, he returned to Cambridge, subsequently becoming a Fellow of King's College. His career, however, was by no means confined to the academic cloisters. As a result of his book *Indian Currency and Finance* (1913)he was appointed to a Royal Commission to examine Indian currency. In 1915 he joined the Treasury, and was given special responsibility for co-ordinating the foreign exchange expenditure of Britain and her allies on essential imports.
* In 1932 he published a two-volume Treatise on Money,a widely acclaimed masterpiece,which was, in many respects, to develop the ideas which formed the basis of his *magnum opus -* **The General Theory of Employment, Interest and Money** - in 1936.
* The Second World War (which Keynes had predicted so long before) brought him back into harness, and in 1940 he became an economic adviser to the Government, concerned with the mobilization of the national economy in support of the war effort. His proposals in *How to Pay for the War*published in 1940- made new demands for restraint and for effective and equitable methods of financing the war (in sharp contrast to the practices of First World War). He developed new methods of national income analysis, which were to have a lasting effect on government accounting.
* He played a significant role in the establishment of the International Monetary Fund, and the International Bank for Reconstruction and Development. He had been raised to the peerage in 1942 and made a number of major contributions to debates in the House of Lords. Married to the famous Balleriana, Lydia Lopokova, of the Diaghilev Ballet, Keynes took a lifelong interest in the arts. He played a leading part in the building of the Arts Theatre in Cambridge, and was responsible for the establishment of the Arts Council. These activities did not preclude him from a shrewd and highly productive involvement in financial affairs; he was Chairman of an insurance company, and he invested in a highly profitable manner, both for himself and for his College (of which he was Bursar).
* In his earlier days, Keynes had been thought by many to be a dangerous, unpredictable, revolutionary character. His pro-German views in 1919 aroused intense irritation throughout the country - Noel Coward was later to write a satirical song called 'Don't let's be beastly to the Germans' which epitomized British impatience with those who were disposed to forgive Germany. But it was his *General Theory* which earned him accusations of undermining the capitalist system, ridiculing sacred economic institutions, and pouring scorn upon the traditional economic virtues of thrift, prudence and initiative. In fact, Keynes was no revolutionary. He stated:

*I think that Capitalism wisely managed can probably be made more efficient for attaining economic ends than any ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life.*

* This, then, was Keynes the man - a blend of radical and conservative inclinations; talented in both analysis and exposition, cultivated in all the arts, shrewd and practical in financial management, skilled in the arts of political debate and negotiation, and deeply committed to some of the major social issues of his time. All these diverse qualities, achievements, and experiences were brought together in his General Theory - a book which, like the Wealth of Nations, persuaded its own generation and governed the next. The full title of Keynes' masterpiece is **The General Theory of Employment, Interest and Money**, but it is usually known as his General Theoryand it is accepted that its main concern is with the first of the trinity of topics in the title, i.e., employment.
* After the Great Depression began in the early 1930s, many economists in the United States advocated policies that later would be called Keynesian. It is interesting to note that these policies were presented before the publication of Keynes' General Theory. Leading figures both inside and outside of the economics profession were urging public work programs, deficit budgets for the federal government, and the easing of credit by the Federal Reserve System. Many economists were aware of the multiplier effect that increased government spending could have on total spending and income. Some theorized that as the national income increased, consumption expenditures rose less rapidly than total income, and saving increased more rapidly. Wages were recognized as a source of demand for goods as well as a cost of production, and cutting wages was frequently opposed as providing no real remedy for unemployment; this was macroeconomic thinking. People derived these ideas independently of Keynes and widely discussed them in the United States. But it was Keynes who provided the analytical framework that integrated these ideas and touched off the "Keynesian revolution'" in economics.
* The monumental work of Keynes ‘General theory’ can be grouped with smith’s wealth of Nations’. Keynes starts his book by distinguishing his own system of analysis from the classical economics. He never tried to extend or modify the old doctrines, but tried to develop a theory entirely different from the classical theory. He was dissatisfied with the classical theory, particularly says law and the attainment of full employment. The classical economists believed that the economy works at full employment under conditions of perfect competition. If at all there is unemployment that is voluntary unemployment and no involuntary unemployment exists under such a system.
* Keynes did not believe that existing economic theory, with its strong *laissez-faire* bias, was capable of providing the remedy for this over-whelming economic and social malaise. The Marxists, he saw, were expressing confidence in their founder's prediction that capitalism was doomed by its inner contradictions, and were expecting its final collapse at any moment. Keynes did not accept this view (it could be urged that his *General Theory* is aimed as much at disproving Marxism, as disproving the theory of *laissez-faire*) but he recognized that unless a new economic theory could be formulated, which gave hope to thousands of disillusioned citizens, then Marxist ideology might well triumph.

***MAJOR TENETS OF THE KEYNESIAN SCHOOL***

* **Macroeconomic emphasis***.* Keynes and his followers concerned themselves with the determinants of the *total* or *aggregate* amounts of consumption, saving, income, output, and employment. They were less interested, for example, in how an individual firm decides on its profit-maximizing level of employment than in the relationship between total spending in the economy and the aggre­gate of such employment decisions.
* **Demand orientation***.* Keynesian economists stressed the importance of *effec­tive demand* (now called aggregate expenditures) as the immediate determi­nant of national income, output, and employment. Aggregate expenditures, said these economists, consist of the sum of consumption, investment, govern­ment, and net export spending. Firms collectively produce a level of real output that they expect to sell. But sometimes aggregate expenditures are insufficient to buy all the output produced. As unsold goods accumulate, firms lay off workers and cut back output. That is, effective demand estab­lishes the economy's *actual output,* which in some cases is less than the level of output that would exist if there were full employment *{potential output).*
* **Instability in the economy***.* According to Keynesians, the economy is given to recurring booms and busts because the level of planned investment spending is erratic. Changes in investment plans cause national income and output to change by amounts greater than the initial changes in investment. Equilibrium levels of investment and saving—those that exist after all adjustments have occurred—are achieved through changes in national income, as opposed to changes in the rate of interest. Investment spending is determined jointly by the rate of interest and the *marginal efficiency of capital,* or the expected rate of return above the cost on new investments. The interest rate depends on people's preferences for liq­uidity and the quantity of money. The marginal efficiency of capital depends on the expectation of future profits and the supply price of capital. The expected rate of profit from new investment is unstable, and, therefore, one of the most important causes of business fluctuations.
* **Wage and price rigidity***.* Keynesians pointed out that wages tend to be inflex­ible downward because of such institutional factors as union contracts, mini­mum wage laws, and implicit contracts (understandings between employers and their workers that wages will not be cut during downturns judged to be temporary). In periods of slack aggregate demand for goods and services, firms respond to lower sales by reducing production and discharging or laying off workers, not by insisting on wage cuts. Prices also are sticky downward; declines in effective demand initially cause reductions in output and employ­ment rather than declines in the price level. Deflation occurs only under con­ditions of extremely severe depression.
* **Active fiscal and monetary policies***.* Keynesian economists advocated that the government should intervene actively through appropriate fiscal and mone­tary policies to promote full employment, price stability, and economic growth. To combat recession or depression, government should either increase its spending or reduce taxes, the latter increasing private consumption spending. It also should increase the money supply to drive down interest rates in the hope that this will bolster investment spending. To counter inflation caused by excessive aggregate expenditures, government should reduce its own spending, increase taxes to reduce private consumption spending, or reduce the money supply to raise interest rates, which will dampen excessive invest­ment spending.
* Keynes started his work by distinguishing his own system from what he calls the *Classical Economics*. He has tried to impress upon his readers that the book is not an extension or a modification of the received doctrines, but a theory entirely different from the classical theory. The methodology of Keynesian economics may be distinguished from neoclassical economics by its concern with aggregate behavior, especially the income generating effect of total expenditure and the emphasis placed on the investment component in determining the level of activity. The development of Keynesian theory has centered around three related topics:

1. the stability of a market system and particularly its ability to maintain full employment
2. the role of money in such a system and
3. the long term dynamics of the market economy
   1. **The General Theory of Employment**

Keynes, himself, says '*The ultimate objective of our analysis is to discover what determines the volume of employment’*and all the conceptsand relationships subsequently discussed must be assessed in the light of this objective. It was failure to understand this fact which misled some of his contemporary critics. Even the scholarly and humane Professor A. C. Pigou was too harsh in his criticism of keynes (a fact he later graciously admitted) because he was viewing his work in the light of Marshallian economics, and had not sufficiently realized the extent to which Keynes had changed the rules of the game.

* Why had Keynes made the determination of the level of employment his main concern? He was, it must be remembered, writing in the mid-1930s, when unemployment was running at an alarmingly high level, and causing wide spread distress and social tension. Whereas in the century before 1914, unemployment in Britain had averaged 3 or 4% between 1929 and 1939 it average 13%, and in 1932 it rose as far as 22%. The end of the 1920s and the start of the 1930s saw the world in the depths of a slump from which it seemed there was little prospect of emerging. The Great Depression of the 1930s (1929-33), which devastated the major economies of the world, triggered the emergence new economic thinking.
* **Theory of Employment**

Keynes was dissatisfied with the classical theory which ran in terms of say’s law and in which there was an automatic adjustment towards full employment. They, thus, believed that there would not be any unemployment in the economy owing to the operation of the forces of competition. And, whatever persons refused to work at a reduced wage, they thought that they were not involuntary unemployed. They considered such behaviors as irrational and did not allow their theory to be affected by it. In this classical system frictional & voluntary unemployment could exist but no involuntary unemployment. But Keynes argues that in the modern capitalist society, no economy is capable to operate at full employment consistently or to have an automatic tendency to secure full employment. According to Keynes, involuntary unemployed person include those who would not be willing to work at a lower money wage.

It is recalled from the thoughts of the Classical School that the economy is always at equilibrium and operates at full employment. For the Classicists, unemployment (or operation of an economy at less than full employment) is the consequence of disequilibrium which will come to full employment automatically when the market becomes at equilibrium. The greatest contribution of Keynes lies in the statement that *unemployment is possible even when the economy is at equilibrium*. It is found that in terms of Keynesian framework there will be an inherent tendency for level of income to settle at less than full employment.

From this analysis we get at two conclusions.

* First, in its own, the type of economy which Keynes is considering will not attain full employment of income and even if it does, it would tend to slide down to a less than full employment level.
* Second, this level of employment can be pushed up by increasing the effective demand, through operating on the aggregate demand function. This operation, if it is to be on the side of consumption, may be coursed through a redistribution of income in favor of those sections of the community who have a higher marginal propensity to consume (*mpc)*, or it may be implemented through various welfare schemes where by added purchasing power come in to those hands which would spend it away.
* **Theory of Wage**

Keynes did not agree with classical economists thought that employment will increase owing to wage reductions. The classical economists like Pigou claimed that the employers were ready to offer more employment if the workers were ready to accept lower wages. If there were unemployment, according to Classicists, it was only voluntary in the sense that workers were not ready to accept lower wages, which correspond to their marginal productivity.

Keynes, however, maintained that Pigou’s argument was faulty in that it ignored the fact of aggregate income. Note that both Keynes and Pogou agreed that the means to increase labor employment was to reduce the real wage level and make it worthwhile for the employers to offer for employment. But they differed as to the mechanism by which it could be done. The classical economists believed that a single employer would offer more employment to workers if they agreed to accept lower money wages. And they generalized to the whole economy and asserted that a general lowering of money would be able to increase employment in the economy. Keynes pointed out that the argument ignored the fact that when money wages were reduced throughout the economy, there would be a reduction in aggregate demand also. This would reduce effective demand and the workers would be left with the same amount of employment.

According to Keynes, wage reduction implies reduction of marginal cost which influences prices to fall. Hence, real wage of the workers may not decrease. For Keynes employment can only increase when there is a fall in the real wage of the workers, especially in the field of consumption goods.

**4.3 Interest and money**

Investment here refers to new investment or current investment. Recall that Keynes has assumed that Consumption depends primarily on real income. In other words, what Keynes called the propensity to consume depends on income except under abnormal conditions like war, earth quakes, strikes, revolutions etc. Given the propensity to consume, the level of output is dependent on the inducement to invest, which in turn, determines the volume of investment Y = f(Inv., ). The inducement to invest depends upon the relation of the current rate of investment to the marginal efficiency of capital; i.e., current investment is a function of marginal efficiency of capital and interest rate.

The *marginal efficiency of capital (MEC) has been defined as the ratio of the expected yield of additional capital assets over a period of time to the supply price of the asset*; i. e. MEC is a measure of expected rate of return or profitability on new investment. The inducement to invest will be strong if the value of an additional unit of capital exceeds its cost. The value of an additional unit of capital depends on the marginal efficiency of capital and on the rate of interest at which these expected annual reforms are discounted.

Apart from the marginal efficiency of capital, the disposition of investors is also affected by the current rate of interest at which they obtain capital. In Keynesian terminology, *the rate of interest is the price paid for parting with cash or liquidity and using it for investment in assets*. Interest, thus, is determined by the liquidity preferences (that is, the preference of an individual or group of individuals for cash to assets).

According to Keynes, the individuals’ preference for liquid assets, or liquidity preference, is mainly: a) for daily transaction (transaction motive) b) for meeting contingent needs (contingency motive) and c) for meeting business needs (or the speculative motive). The rate of interest is, thus, the price paid to an individual for parting with his liquidity preference. Obviously, the higher the liquidity preference, the higher will be the rate of interest and vice versa. Similarly, the fall in the quantity of money, the rate of interest would rise and with an increase of it the rate of interest will decrease.

One important comment, here, is the existence of *liquidity trap* a phenomenon which develops when the rate of interest falls and touches the normal floor limit; i.e., the lower limit below which it is not expected by the market to fall. This phenomenon of liquidity trap implies that after the rate of interest has fallen to a certain level, liquidity preference may become virtually absolute in the sense that almost everyone prefers cash to holding a debt which yields so low rate of interest.

**4.4 The concept of the multiplier (**From your macroeconomics lesson, what do you remember about multiplier? )

Keynes became famous for the development of the theory of multiplier which is so intimately connected with the marginal propensity to consume. But Keynes has never claimed for the originality of this concept of multiplier in to economic theory. From the previous discussions it is evident that the aggregate income of the community is determined by the rate of investment together with the propensity to consume. The basic idea of multiplier is that just as in a river the creation of one wave gives rise to a number of waves. Similarly, in an economy each injection of money gives rise to a series of new money. *The multiplier means that with a given consumption function, if net investment is increased (say by government or some other public authority), a multiplier process will be introduced which will cause an increase in income which will be a multiple of the initial net investment which started the process.*

The value of this multiple by which the income increases (or the ratio of the increase in income to the initial increase in net investment causing that investment) is called by Keynes as multiplier. If an investment of $1million causes an increase in the total income by $3million, the multiplier is 3, in case the increased income amounts to $2milliom, the multiplier is 2. The multiplier is, thus, a number by which the increase in investment must be multiplied in order to give the resulting increase in income. Or, it is a numerical coefficient indicating how great an increase in income results from each increase in investment. The value of this multiplier obviously would depend up on the value of the mpc.

The question is how and why the increase in the total income is more than incorporation to the increase in the investment? The reason is that with each investment, the resultant expansion in production and national income is much more than the primary investment. Apart from this, increased income will be spent by the wage earners and by the recipients of profits and interest leading to increased income to others in the economy. This increased income will go on repeating like this. [In case, with an increase in income, there is no increase in consumption, the multiplier effect will be zero. Thus, the amount of the multiplier is determined by the relative proportions of spending and saving, out of increased income].

If for every dollar of additional income, three-fourth is spent and one-fourth is saved, then the aggregate addition to income is 1+3/4 + 9/6 + 27/64 and so on. That is, initially $ 1 is spent, the first individual save ¼ of it and spend ¾ of it. This ¾ is income for the 2nd individual. The 2nd individual will spend only ¾ of 3/4  which will be income of 3rd individual. The 3rd individual will spend only ¾ of   which will be income of 4th etc. The process will go on. It can be observed that this creates a serious of geometric progression with a common ratio of ¾. The total income generated due to the first dollar investment will be the sum of this geometric progression. From our little knowledge of Algebra, we can compute the total income generated from this process using the formula



Where Sn = sum of the first n terms

G1 = the first term

r = common ratio.

But, in our case, n cannot be determined and hence we will use the formula for sum of infinite serious. For when n increases continuously,is close to zero. Accordingly Sn =  is close to the number  and we say that the series Sn converges to. Hence, for G1 = $1, r = ¾ the sum of income series is Sn = 

i.e., the ratio of the increment in total income to the volume of investment is 4:1 and therefore the multiplier is 4. Multiplier depends upon the propensity to consume which, in turn, determines the proportion of savings out of each increment. Whatever the multiplier, the total savings during all the turnovers will necessarily be equal to the original investment. It would, thus, be observed that investment will result in an increase in income up to the point at which the saving would be equal to it. More technically, the multiplier is just the reciprocal of marginal propensity to save.

i.e, m = 

This implies that the stronger the propensity to save, the smaller will be the increase in income and vice versa. On the other hand, the higher the consumption function (or the propensity to consume) or the higher the spending the greater will be the multiplier.

If c = 2/3, m = 3

If c = 1/3, m = 2

If c = 3/4, m = 4

* 1. **Theory of price & Consumption**
* **Theory of price:** In his analysis of price, Keynes agreed with the orthodox/classical view that increase in the quantity of money in circulation leads to an increase in the price level. The basic difference between Keynesian analysis & this classical analysis is regarding the process through which this effect is caused (i.e., on the transmission mechanism). As a matter of fact, the classical quantity theory of money failed to analyze the process through which the price would be affected. Keynes tried to fill in the gap. The transmission mechanism according to Keynes is as follows. Increase in the supply of money is likely to increase the availability of funds. This increase in money supply tends to lower the rate of interest and increase the demand for investment which ultimately leads to an increase in income employment and output. This increased output can only be possible at an increasing cost, beyond a certain point, price will accordingly rise. It would just be observed that Keynes has established the relation between quantity of money and the price through output.
* **Theory of Consumption Function (Propensity to Consume):** Keynes’s formulation of the consumption function is considered as an epoch making contribution to the tools of economic analysis (analogous to, but even more important than Marshall’s discovery of the demand function). According to Keynes, the consumption function is the ratio of consumption to income. This function taken for granted, the level of income is determined by volume of investment, of course, without taking the time lags in to account. Consumption determines demand which in its turn, leads to the production of commodities as well as capital. It is the lack of “effective demand” or lagging consumption that creates crises and generate depression.

Keynes has asserted that the total income and the total expenditure of a nation are closely related. i.e. the amount which the community would like to consume depends up on the expected income for the period under consideration. At very low expected income the amount which the community would like to consume would exceed that income. [Keynes confines himself to short period only in which the change in consumption is bound to lag behind the change in income]. However as expected income rises, the planned consumption also rises, but not as fast as income. In other words, the marginal propensity to consume (which is defined as the ratio of increase in planned consumption to the increase in expected income) would be less than one; i.e. due to the psychological tendency of people, when income increases expenditure on consumption goods doesn’t increase proportionately .

On the basis of this assumption, Keynes takes up the analysis of the factors governing output and employment. The economy which Keynes has in mind is a capitalist developed one but it is a closed economy. According to Keynes, total income (Y) is comprised of the income earned through consumption Goods(c) and the income earned through investment goods (I ).

i.e. Y = C + I

On the other hand, of the total income (Y) ,a part will be used for consumption (C) and the rest for saving (S)

i.e. Y = C + S

Hence, Y = C + I , or Y – C = I

Y = C + S, or Y – C = S

I = S

Thus, it is clear that during any period of time, saving and investment consist of the flow of income which the receiving people are not spending on consumer goods.

* 1. **Classical Economics Vs Keynesian Economics**

1. The analysis of wages and employment, the attack on savings, and the emphasis on spending are the revolutionary elements in Keynesian economics.
2. Keynesian Economics leads to a set of questions which involve the possibility of equilibrium at different levels of employment (and in which full-employment is a possibility but under-full employment a greater possibility) the neutrality of money, and also the stability of price level. Now in Keynes, full employment is not attained because of rigidity of real wages. And even if wages are assumed flexible in the Keynesian system full employment may not be achieved on account of two further possibilities; the possible interest in elasticity of consumption and investment function, and the phenomenon of liquidity trap.
3. Keynesian economics is more practical and effective than the classical economics. It is institutional in the sense that it gives due importance to institutional factors explaining high rates of interest, inadequate supplies of money, over-saving, uncertainties, rigidity etc.
4. Keynes regards laissez faire as a lost force. According to Keynes, the chief result of laissez-fair policy were deficit demand, unemployment, waste of resources, etc. He rejected the laissez-faire philosophy because the classical economists were interested in the distribution of the product and not in the employment of economic resources of the country. Classicists assumed that all incomes earned in production of commodities would be used for purchasing them. Hence, Keynes felt that adequate attention was not given to effective demand and its relation to supply function. Keynes found that the failure to spend current income on consumption and investment goods was the chief cause of unemployment. Hence, he pleaded for controlling consumption, savings and investment.
5. It would be interesting to observe that Keynes was not against capitalism as such but he was critical of its parasitic elements (such as excess savings, high rate of interest). Keynes found one of the chief benefits of capitalism to be the free play it gives individualism. What abuses do come from individualism, he believed, could be corrected without destroying capitalism. The chief defects or faults of capitalism, he said, “are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes.”18 The Depression of the 1930s convinced many economists that the failure to provide full employment was a major fault of capitalism. What policies can we use to preserve the best of capitalism and simultaneously prevent major depressions? Keynes’s views on policy seemed at first too liberal for many people in the United States. The monetary and fiscal policy suggested by the Keynesians were finally embraced by U.S. economists, because they required little direct government intervention in the economy.
6. Keynes has also criticized classical theory regarding rising wage rate and its relation to unemployment. For Keynes, level of employment is determined by effective demand and that a stimulation in effective demand comes through changes in the marginal propensity to consume
7. Keynesian theories were one of the most influential one in the formulation of public policies. Of course, no other economist had so large influence on public policy particularly in so short time as Keynes. In the domain of fiscal measures, Keynesian concept of deficit spending has been the most popular. Keynes suggested that a sound policy of public finance must aim (a ) keeping the rate of interest as low as possible so as to force capital to undertake investment risks in order to earn profits ( b) supplementing a private investments by government spending (c) adopting a progressive tax system which would adversely affect savings and thus help in maintaining the level of consumption in the country.
8. Keynes revolted against the classical approach of dichotomy, in which the physical and monetary aspects of the economy are treated as separate and the functioning of one will not affect the other. But in the Keynesian system a complete integration between the two dimensions of the economy is attempted. In the case of a firm or an industry, when it comes to question of what determines out put and employment, it requires the complete theory of monetary economy. The importance of money according to him is it acts as a link between the present and the future and it is even difficult to discuss the changing expectations except in monetary terms. The major objective of Keynes was to analyze the determination of output and employment in the economy and for this he makes use of the concepts of aggregate supply function, Aggregate demand function and the effective demand. Effective demand of an economy is the point where the ASF and the ADF intersect each other.Effective demand is composed of two quantities. The amount, which the community is expected to spend on consumption, and the amount which it is expected to spend on new investment. It leads to the analysis of consumption function and investment function. Up to the stage of full employment, an increase is effective demand led to a corresponding increase in real output and employment. According to him full employment is that level of economic activity beyond which real output and therefore employment cannot be increased.

**Points of Strength**

* It was Keynesian achievement to show the inherent weakness of the classical economics which assumed self adjusting mechanism of the economy for attaining full employment.
* Keynes provided a complete theory in which both monetary & fiscal aspects of the economy were properly integrated and influenced each other
* Keynes was able to counteract a number of preventing myths in economic theory & policy prescriptions. Among the then prevailing challenges up on which Keynes shed a light of hope are
  + The relationship between employment & wage rate. For Keynes it is only when real wages declines (not monetary wage) that employment increases.
  + To avert economic crises, interest rate should be lowered so that investment will be encouraged
  + Saving will end up with less saving via curtailment in effective demand and employment.
* Keynes also shed new light on the motives for holding money by referring to the liquidity attributes of money which made it desirable asset in comparison with other assets.

**Points of Weakness**

* His General Theory (the book that immortalized his name) was severely criticized for its bad style. This creates a friction for Keynes’ thought to be understood & accepted by his fellow. Keynes can also be legitimately criticized for assuming that the businessman would be facing definite and stable demand & supply function. In other words, Keynes made only a limited use of expectations and did not extend the treatment by the element of uncertainty. For example, his marginal efficiency of capital is based on the assumption that future flows of expenditure and receipts can be estimated with certainty.
* Keynes rejected the orthodox stand that both saving and investment were interest elastic and equal. Having rejected the interest elasticity of savings he could show that savings, and investment could be continuously unequal ex-ante but Keynes was not able to bring about a fuller treatment of the theory of interest.
* Keynes may also be criticized for ignoring the portions of value and distribution. He is also accused of confining his analysis to those cases where the money markets are fully developed. He also chose to concentrate chiefly up on the working of the economy before full employment and left out the actual process of adjustment while discussing the interactions between various determining variables.
* Keynes's short-run static thinking fed him to exaggerate the trend toward secular stagnation. Like many economists before him, he thought that the profitability of new investment would decline as the most profitable projects were undertaken first, leaving less attractive projects for later exploitation. In saying so, Keynes underestimated the possibilities of technological change and the new capi­tal investments it would stimulate.
* Keynes was narrowly provincial with respect to both space and time. He seemed to think that unemployment might have become a problem in ancient Egypt and in the Middle Ages had it not been for the building of pyramids and cathedrals. His analysis of mercantilism strongly implied that the problems of 1636 were the same as those of 1936: "There has been a chronic tendency throughout human history for the propensity to save to be stronger than the inducement to invest." He thought that throughout history the weakness of the inducement to invest had been the key to the economic problem.
* Keynes also can be criticized for his too-ready acceptance of wasteful govern­ment spending. To be sure, he preferred that the state finance useful, rather than useless, projects. But he recognized that the business community might condemn useful public works if they competed with private enterprise. In such a situation wasteful spending was preferable to serviceable projects and was much better than doing nothing at all.
* Keynes was sympathetic toward private-wasteful-consumption spending as well as public waste. He defended Bernard de Mandeville's *The Fable of the Bees: or, Private Vices., Publick Benefits* (1705), which told of the appalling/awful plight of a prosperous community that suddenly abandoned luxurious living and amusements in the inter­est of saving.