

A: The Keynesian school

- Emerged as a reaction to the theories of the classical school of thought; Keynes reacted against the classical idea of full employment equilibrium.
- The major tenets of the Keynesian school vary considerably from those of the classical school [see PowerPoint slide number 1 of study unit 7].
- Keynes's major contribution was the *macroeconomic emphasis*, according to which total/aggregate production in the economy is determined by the effective demand by household (C), firms (I), government (G), and the external sector through the exports and imports (X- M).
- Keynes attacked the neoclassical idea of *price flexibility*, according to which the market is believed to "clear" itself back to equilibrium whenever there is any excess demand or excess supply in the market.
- Keynes instead, believed that prices and wages are *rigid*, therefore only fiscal policy and monetary policy can be used to stimulate aggregate demand or to reduce inflation.
- Fiscal policy and monetary policy however, *have negative side effects*: (i) any expansionary policy (whether fiscal or monetary) results in increased output and employment, but also results in increasing prices (inflation). (ii) Any contractionary policy (whether fiscal or monetary), helps to reduce inflation, but also results in reduction in output and employment (i.e. increased unemployment).
- The negative side-effects of demand management policies (i.e. fiscal policy or monetary policy) are implied in the Phillip's curve, according to which there is a trade-off between inflation and unemployment.
- The conclusion is that, within the Keynesian framework, it is impossible to solve inflation and unemployment at the same time, because high output and employment coexist with high inflation, and low inflation coexists with high unemployment. This is one of the weaknesses of the Keynesian school.
- Note the criticisms of Keynes and Keynesianism [see PowerPoint slide number 3 of study unit 7].

B: The Post Keynesian school

- You must be able to note what differences and similarities the post Keynesian school has with the mainstream Keynesian school.
- Like the Keynesian school, the post Keynesians used the macroeconomic approach, and also embraced the role of government in the economy.
- Unlike the mainstream Keynesian school, in the post Keynesians' view, inflation is not solely caused by excess demand for goods, but it also depends on cost of production.
- While, the mainstream Keynesians prescribed fiscal policy and monetary policy, the post Keynesians recommended incomes policy.

C: The New Keynesian School

- You must be able to note what differences and similarities the New Keynesian school has with the mainstream Keynesian school.

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- Like the Keynesian school, the post Keynesians used the macroeconomic approach, and also emphasised the role of government in the economy, as well as rigidity of wages and prices.
- The new Keynesians provide several reasons for price and wage rigidity [see PowerPoint slide number 6 of study unit 7].
- The new Keynesian rejected the neo Ricardian approach of the post Keynesians.