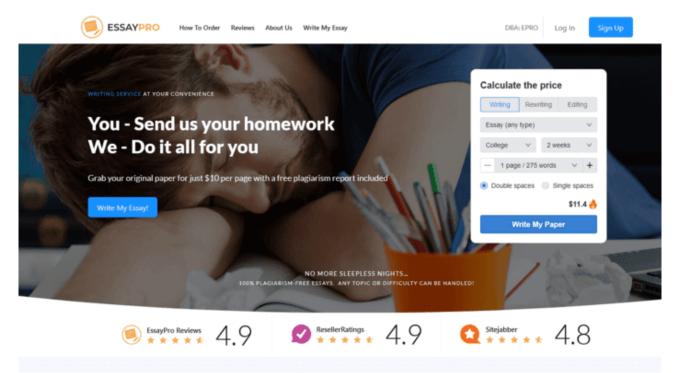
## **Keynesian Economics**



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Macroeconomics is the branch of economics concerned with the aggregate, or overall, economy. Macroeconomics deals with economic factors such as total national output and income, unemployment, balance of payments, and the rate of inflation. It is distinct from microeconomics, which is the study of the composition of output such as the supply and demand for individual goods and services, the way they are traded in markets, and the pattern of their relative prices.

At the basis of <u>macroeconomics</u> is an understanding of what constitutes national output, or national income, and the related concept of gross national product (GNP). The GNP is the total value of goods and services produced in an economy during a given period of time, usually a year. The measure of what a country's economic activity produces in the end is called final demand. The main determinants of final demand are consumption (personal expenditure on items such as food, clothing, appliances, and cars), investment (spending by businesses on items such as new facilities and equipment), government spending, and net exports (exports minus imports). Macroeconomic theory is largely concerned with what determines the size of GNP, its stability, and its relationship to variables such as unemployment and <u>inflation</u>. The size of a country's potential GNP at any moment in time depends on its factors of production-labor and capital-and its technology. Over time the country's labor force, capital stock, and technology will change, and the determination of long-run changes in a country's productive potential is the subject matter of one branch of macroeconomic theory known as growth theory.

The study of macroeconomics is relatively new, generally beginning with the ideas of British economist <u>John Maynard Keynes</u> in the 1930s. Keynes's ideas revolutionized thinking in several areas of macroeconomics, including unemployment, money supply, and inflation.

## Keynesian Theory and Unemployment

Unemployment causes a great deal of social distress and concern; as a result, the causes and consequences of unemployment have received the most attention in macroeconomic theory. Until the publication in 1936 of The General Theory of Employment, Interest and Money by Keynes, large-scale unemployment was generally explained in terms of rigidity in the labor market that prevented wages from falling...

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...ould be willing to accept a lower wage in order to get a job. However, by widening the range of variables over which individuals optimize to include variables such as loyalty and self-respect, it has become easier to reconcile labor market disequilibrium with the usual assumptions of optimizing behavior.

Macroeconomic theories regarding the way that the determinants of total final demand operate form the basis of large macroeconomic models of the economy that are used in economic forecasting to make predictions of output and employment and related variables. During the last few years, the record of most such predictions has been poor, and an analysis of the errors has led to continual revisions of the basic models and refinements of the theory.

## Phillips curve

The Phillips curve illustrates the trade-off found by economist A. W. Phillips between lower unemployment and increased inflation. If unemployment is low at 4 percent, inflation is slightly high at 6 percent (point a). If inflation is eliminated, unemployment increases to 8 percent (point b). The trade-off poses a dilemma for policy-makers, although economists disagree on whether this relationship exists.

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