INTRODUCTION

V. Chich

Debate—Or a Beginning?

Keynes: The End of the Keynesians, Monetarists, and

Post-Keynesian Economic Theory
MODES OF MONETARY CHANGE

Although monetary change involves some other causes as well, focus

on one new direction.
DEFICITS FINANCED BY NEW MONEY

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RESPONSE OF CONSUMERS

When household income rises, it is typically assumed that both consumption and saving increase. However, if we consider the concept of the Keynesian consumption function, we can see that consumption is not only influenced by income but also by wealth. In other words, the increase in income may lead to an increase in consumption, but it also depends on the consumption elasticity of income, which measures how responsive consumption is to changes in income.

The Keynesian consumption function is often represented by the equation:

C = a + b(Y - T)

where C is consumption, a is the intercept, b is the marginal propensity to consume, Y is income, and T is taxes.

The marginal propensity to consume (MPC) is the fraction of additional income that is spent on consumption. It is an important concept in Keynesian economics, as it affects the responsiveness of the economy to changes in income.

In the short run, when income increases, consumption may also increase, leading to a rise in spending and output. However, in the long run, the MPC is typically less than 1, meaning that a portion of the increased income will be saved. This is because higher income may lead to higher marginal saving, as people may save a larger portion of any additional income they receive.

In conclusion, while an increase in household income is generally associated with an increase in consumption, the actual effect depends on the MPC and other factors such as wealth and the distribution of income. Understanding these relationships is crucial for economists and policymakers in formulating effective economic policies.
FURTHER CONSIDERATIONS

Interest rates are affected by many factors, including the supply of and demand for loanable funds. The interest rate is the price of money, just as the price of any other good or service is the price at which it is exchanged. Interest rates are determined by the forces of supply and demand in the market for loanable funds. The interest rate is the return that lenders require for loaning their money, and it is the cost that borrowers pay for the use of that money.

RESPONSE OF FIRMS

The response of firms to changes in interest rates is an important consideration. Firms borrow money to finance their operations, and the cost of borrowing affects their profitability. When interest rates rise, the cost of borrowing increases, which can lead to lower profits. Conversely, when interest rates fall, the cost of borrowing decreases, which can lead to higher profits. Firms may adjust their investment plans and production levels in response to changes in interest rates.

For Keynesian Economic Theory
The phrase 'marginal propensity to consume' refers to some certain marginalism in the concept of demand curve. The marginal propensity to consume refers to the change in consumption resulting from a change in income. When the marginal propensity to consume increases, the demand curve shifts to the right, indicating that consumers are willing to spend more at each income level. Conversely, when the marginal propensity to consume decreases, the demand curve shifts to the left, indicating that consumers are willing to spend less at each income level.

**Figure 4.1**

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**Money Creation by Bank Lending**

Bank lending can be seen as a way to create money. When a bank lends money, it increases the supply of money in the economy. This is because the bank creates money by crediting the borrower's account with the amount of the loan.

1. **Deposit Creation:** When a bank lends money to a borrower, it creates a deposit in the borrower's account. This increases the amount of money available for lending by other banks.
2. **Leverage:** Banks can lend out a portion of their deposits, known as leverage. This means that a bank can create new deposits and loans by holding a portion of the deposit in reserve and lending out the rest.

These processes show how banks can create money through lending. The amount of money created depends on the reserve requirement and the leverage ratio.
The monetary authorities have always found it some comfort that loans, at least as long as the DL has some elasticity, demand will fall below even excess unutilized capacity. However, there will be increased interest rates—though some increase may occur in the short term. Banks, faced with the greater uncertainty and increased risk of lending, will be more careful in making loans. An increase in the demand for loans is likely to reduce the money supply. In the previous section it was shown that the bank cannot create money by an expansion of the reserve ratio. The banks, therefore, will not lend more. The argument that a decrease in the interest rate will not induce banks to lend more is based on the Keynesian view that the money supply is influenced by expectations of future interest rates. In the current scenario, the money supply is expected to decrease, which will reduce the demand for loans. Therefore, the money supply decreases, and the interest rate increases.
In summary, monetary policy operates through a framework that involves setting interest rates and open market operations to influence the federal funds rate and other key interest rates. When the Federal Reserve, which is the central bank of the United States, decides to implement an expansionary monetary policy, it typically involves reducing interest rates. This action makes it cheaper for banks to borrow money from each other, which in turn makes it cheaper for businesses and consumers to borrow money for various purposes. The goal is to stimulate economic growth by increasing the money supply, which can lead to higher aggregate demand and potentially lower unemployment.

Expansive monetary policies are often used during economic downturns or recessions, as they can help to boost demand and encourage consumption and investment. Conversely, during periods of inflation or overheated economies, contractionary monetary policies, such as increasing interest rates, might be employed to prevent further economic overheating or to reduce inflationary pressures. The Federal Reserve, through its monetary policy decisions, aims to maintain a balance that supports economic stability and growth.
RESOLUTION: A BEGINNING?

The resolution of monetary policy is often discussed in the context of the effectiveness of open market operations. The effectiveness of open market operations is often measured by the change in the supply of money and the impact on interest rates. In this case, the open market operations are effective if they result in a desired change in the supply of money.

OPEN MARKET OPERATIONS

The open market operations are conducted by the central bank, which buys or sells government securities. The purchase of government securities increases the supply of money, while the sale of government securities decreases the supply of money. The effectiveness of open market operations is measured by the change in the supply of money and the impact on interest rates.

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NOTES

For actual policy, the effects examined by applying based on

Keynesian, monetarists, and keynesian

world.