Keynes’ Critique of Classical Economics

Student’s Name and Surname

Course

Due Date

John Maynard Keynes was an economist who created a macroeconomic school of thought named Keynesian economics, which criticized the postulates of classical economics—a prevalent way of thinking at the time. His critique of classical theory has a number of significant points, including the lack of full employment, state intervention, and Say's Law of Markets. Unlike classic theorists, he recognized the superior role of money in macroeconomics and believed that wage-cutting was not the ultimate cure for unemployment. Keynesian economics was prominent at the time it was introduced, as it challenged the singularity of thoughts among scholars and promoted standards that were effective for the economy after the Great Depression.

The first significant point of Keynes' critique is related to the phenomenon called "underemployment equilibrium." He argued that the state of full employment is not likely to exist, since underemployment is likely to be always higher than the natural rate of unemployment due to the weaknesses found within laissez-faire capitalism. [1] Underemployment in Keynes' economy depends on the stability of the job market, with overqualification and overstaffing being the two most regular cases of underemployme[2] Classical economics recognizes that full employment creates the problem of distributing resources between industries.[3] However, Keynes believed that this would not be the case, because the effective allocation of resources is impossible due to their enormous waste levels within the free-market economy.[4]

The second argument that Keynes used to criticize classical theory is concerned with the inevitable nature of state intervention into the economy. Keynes concluded the inevitability of

---

1 Brendan Sheehan, *Understanding Keynes' General Theory* repr., (New York: Palgrave Macmillan, 2009).

2 Ibid., 26.

3 Michel Rosier, "The Logic Of Keynes' Criticism Of The Classical Model", *The European Journal Of The History Of Economic Thought* 9, no. 4 (2002): 608-643.

4 Ibid., 634.

such an intervention by expanding his theory of underemployment equilibrium. To him, intervention is a necessary component of downturns in economic activity, such as depression and inflation.[5] Unlike supporters of classical economy, Keynes believed the private sector of the economy is subjected to sudden prolonged falls that can only be fixed with government intervention. Within this scenario, aid usually comes in the form of public investments. [6] Keynes went as far as to advocate for state intervention, because he saw it as a way to prevent constant shifts in the private-sector economy.

One of the key criticisms made by Keynes regarding classical theory was the one of Say's Law of Markets—one of the most significant rules of classical theory. The passage that Keynes criticized extensively suggested that supply creates demand. Keynes also stated that unemployment and general overproduction were non-existent elements. The criticism was based on the notion that income is never spent to the extent that makes employment of all factors of production possible. Keynes stated that unemployment makes it impossible to spend income that is available at the moment on production goods and consumption, which means that supply does not automatically result in the increase of demand. [7] Therefore, fluctuating income in the free-market economy prevents the Say's Law of Markets from being a realistic outcome.

The classical theory of economics implies wage cutting to be one of the most effective solutions against unemployment. However, Keynes saw such a method as an unreliable method, as it reduced the purchasing power of employees together with unemployment. [8] He stated that the presumably increased competition in the job market was unlikely to help because of the

5 Sheehan, *Understanding Keynes' General Theory*, 193.
6 Ibid., 268.
7 Ibid., 193.
8 Rosier, "The Logic Of Keynes' Criticism Of The Classical Model", 628.

decrease in the level of sufficient demand. What is more, he saw the effective cutting of wages to be impossible due to the growing influence of trade unions that possessed the power of influencing the amount of pay.

Unlike classical theorists, Keynes recognized the value of money as an active force capable of bringing changes to the economy. [9] To him, the concepts of employment, money, and income were primarily interconnected. Whereas various classicists suggested money to be either an elusive element or merely an accounting device, Keynes recognized its essential influence on economic output, employment rates, and income. He also criticized classical theory for its one-sided, negative view of inflation, as he believed that money had a more sophisticated impact on inflation rates than classicism suggested. [10] John Maynard Keynes even stated that some level of inflation was necessary to prevent the situation in which prices are following at a persistent rate because of the productiveness of the state's economy, and consumers are learning to postpone their purchases in a search of a more cost-efficient purchase.

To summarize the arguments mentioned, Keynesian economics was a massive shift from the classical point of view on macroeconomics. Denouncing the rules that were considered obligatory brought new perspectives into the science of macroeconomics. The essential points of critique were those that rejected what was supposed to be axioms of macroeconomics, including Say’s Law of Markets and the statement that wage-cutting reduces unemployment. Despite losing popularity earlier in the 20th century, Keynesian economics reemerged as a popular school of thought after the 2007-2008 financial crisis.

---

[9] L. E. Johnson, Robert Ley and Thomas Cate, "Keynes' Theory Of Money And His Attack On The Classical Model," *International Advances In Economic Research* 7, no. 4 (2001): 409-418.

[10] Ibid., 415.

Bibliography

Johnson, L. E., Robert Ley, and Thomas Cate. "Keynes' Theory Of Money And His Attack On The Classical Model". *International Advances In Economic Research* 7, no. 4 (2001): 409-418. doi:10.1007/bf02295770.

Rosier, Michel. "The Logic Of Keynes' Criticism Of The Classical Model". *The European Journal Of The History Of Economic Thought* 9, no. 4 (2002): 608-643. doi:10.1080/09672560210000024682.

Sheehan, Brendan. *Understanding Keynes' General Theory*. Reprint, (New York: Palgrave Macmillan, 2009).