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A Brief Introduction to the Development of (Traditional) Macroeconomics

Macroeconomics is the study of the behavior of the whole economy. The fundamental theories of macroeconomics are developed by the economists of the first world and apply to the developed, industrialized capitalist economies. A capitalist economy is one where productive assets are owned either directly by individuals or by individuals through the medium of firms. In such an economy, economic decisions are taken by individuals and firms acting independently of one another and coordinated via the market mechanism.

The way in which we nowadays study macroeconomics largely owes its origins to John Maynard Keynes's *The General Theory of Employment, Interest and Money* published in 1936. In his classic work, Keynes set out to challenge the mainstream neoclassical economic thoughts of those days, which Keynes castigated as unable to explain or offer policy solutions for the high level of unemployment which, in Great Britain rose to 22 percent in 1932.

The main premise of neoclassical economics is that markets do work and that price signals will bring about the necessary adjustments in the economy in response to economic changes. Neoclassical economics grew out of the marginalist school (e.g., Alfred Marshall, Leon Walras and others) of the latter part of the nineteenth century which developed economic theory on the basis of the optimization (or maximizing) behavior. A main policy conclusion of the neoclassical economists of that period was that government intervention to regulate the economy was unnecessary and brought about distortions.

On the contrary, Keynes argued that once an economy had moved into a situation of high unemployment, the price mechanism would not work to adjust the economy back to the level of high employment. Instead, the government needed to raise the demand for output by increasing public expenditure. Once demand had increased firms would supply more output and employ more labors, which in turn would further increase demand. A characteristic feature of Keynesian demand management policy has always been a reliance on fiscal policy and a somewhat disregard for the efficacy of monetary policy. 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. Keynes's emphasis on demand as the key determinant of output in the short run stimulated developments in many other fields of macroeconomics.