response was to let the market adjust itself, even if it meant entire industries crashing and losing their value completely. Secretary of the Treasury Andrew Mellon's solution was: "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate."
Classical theory still insisted unemployment was voluntary or temporary, wages would fall and things would recover. But in reality, as wages dropped, unemployment fell. Caused by more than stock market crash of 1929.

4. Who is John Maynard Keynes?
See page 347 and class notes for details. Answers may include:
The "Inventor of Macroeconomics". The "savior of capitalism" because the global depression was making it possible elsewhere in the world for fascist and communist governments to take power. Author of the 1936 book, The General Theory of Employment, Interest, and Money.
Changed economists' analysis of business cycles, price levels, labor markets, and economic growth. Provided ideas for how government intervention could decrease unemployment and prevent slumps in the business cycle from turning into severe recessions or depressions. In his analysis, it is no problem for government to borrow in order to increase public spending that would help stimulate consumption and business activity. Argues against balanced budgets during recessions, and that government can break the spiral of depression by borrowing to finance public spending to restore consumer activity, business confidence. These interventions are seen as a major cause of the postwar period of prosperity.
Assumption: market forces won't reliably generate full employment.
Keynes: "In the long run, we're all dead."

5. What is equilibrium for Classical Economists? What is different about it for Keynes?
There are two major differences that we have seen so far. The first difference has to do with employment. For classical economists, equilibrium in the labor market is always at full employment, meaning that there would be no (or very little) unemployment. Classical theory says that the equilibrium is reached because the price of labor, wages, is determined by where the demand for labor meets the supply for labor. For Keynes, employment is determined in a more different way, so the economy could be at equilibrium without being at full employment. For Keynes, it is possible for equilibrium to be at full employment, but this is not the only possible equilibrium point; there are infinite other possible equilibrium points.
Another difference in what "equilibrium" in the macro-economy means for classical economists and for Keynes is in the determination of savings and investment. Classical Economists say that savings = investment because they are determined by interest rates. Keynes agreed that savings = investment, but for Keynes the mechanism is income. That is, Keynes' model suggests that people's decisions have more to do with income than interest rates. People decide how much they will save depending on what their income is, how much they want to consume, and then use whatever is left over.

6. What are Leakages and Injections…why are they important to Keynes?
A "leakage" is a "transfer of funds out of the income and spending flows" (pg 350). Leakages in the Keynesian model are: Savings, Taxes, and Imports. You can think of them as expenditures. "Injections" are funds that enter the income and spending stream, such as government spending, investment, and exports. You can think of these as output/income. Leakages and injections are important because injections must be equal to leakages for the economy to be in equilibrium. The result is that in equilibrium, aggregate expenditures equal aggregate output (income).

7. What are the special Leakage and Injection that Keynes believed could be the agent of change, the pilot, in a downward trending economy? Explain.
In a depression, the government could "inject" money into the economy in order to increase income, employment and output. To avoid inflation, the government could cut government spending or increase taxes (page 355).