GOVERNMENT DEGREE COLLEGE WARANGAL
RANGASAIPET
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DEPARTMENT OF ECONOMICS

STUDENT STUDY PROJECTS

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Title

KEYNESION THEORY OF INCOME AND EMPLOYMENT

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An: There were some theories of Employment even before Keynes. But it was lord Keynes that developed a systematic and scientific theory of employment. He wrote his theory in his book "General Theory of Employment, Intrest, and Money". His theory can be stated as follows.

1. Empolyment is a function of output: Employment depends on output. when production increases, employment increases. when production falls Employment falls.

2. Employment is determined by aggregative demand and aggregative supply:

ⓐ Aggregate Supply function (or) Aggregate Supply Schedule: often
To produce goods and services and Employ labour, the
Employers or business firms have to incur costs. Therefore,
aggregate Supply function or supply schedule or supply price
is the Minimum amount of Money which the enterpreneurs
in the economy must receive by selling the goods and
Services at different levels of output and Employment. If
they have to keep up that level of output and Employment.

ⓑ. Aggregate demand function or Schedule: Aggregate
demand is the total amount of money which the enterpreneurs
expect to receive from the sale of the output.

Aggregate demand consists of total expenditure on
consumption and Investment (C + I).

Employment and output determination: According to keynes
Employment and output is determined by aggregate supply
and aggregative demand. If aggregate demand is more
than the aggregate supply, employment and output increases.
If aggregate demand is less than aggregate Supply, employment
and output will fall.

Effective Demand: Effective demand is that Which equates aggregate
demand and aggregate Supply.

Full Employment equilibrium and under Employment equilibrium:
When aggregate demand and aggregate supply are equal, it
need not necessarily be full employment equilibrium. Even before
full employment is reached, aggregate demand May be equal
to aggregate Supply.

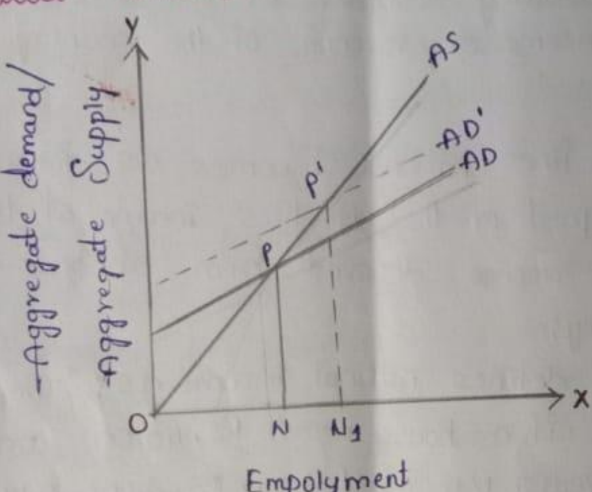
There will be underemployment equilibrium due to deficiency
of aggregate demand: Aggregate demand is the total consump
-tion and investment expenditure [C+I]. As income increases,
the propensity to save increases, investment opportunities fall.
Keynes thinks that underemployment equilibrium is to normal.

feature of a free Market economy. His theory is, therefore, often called "Demand Deficiency Theory".

To achieve full employment aggregate demand should be increased:

Aggregate demand consists of consumption expenditure and investment expenditure. According to keynes consumption expenditure remains constant in the short period and there is no scope to increase it. Therefore, the increase in output and employment will be several time to the initial expenditure. It depends on the value of multiplier and acceleration.

Diagrammatic Representation :



AS, is the aggregate supply curve. AD is the aggregate demand curve. AS and AD intersect at point P. ON is the empolyment equilibrium.

But ON is underemployment equilibrium because full employment is ON_1. At ON employment equilibrium there are still NN_1 unemployed. To reach ON_1 full employment equilibrium aggregate demand AD has to be increased to AD'.

Can keynes theory be applied to developing countries like India:

Keynes theory may not be applicable to the underdeveloped or developing countries. In these countries, employment cannot be increased by merely increasing aggregate demand because capital and some important factors of production will be scarce to increase.