B.A.I

Multiplier

Meaning –

= The concept of multiplier occupies an important place in keynesian theory of income, output and employment.

= According to keynes, employment depends on effective demand, which inturn, depends on consumption and investment ($Y = C + I$). Consumption is stable in the short run and MPC is less than unity. Therefore all the increases in income do not go to increase consumption, a part of the total increased income is saved for investment.

= Multiplier means an intial increment in investment increases the final income by many times. To this relationship between an initial increase in investment and the final increase in aggregate income is known as investment multiplier.

= The multiplier is the reciprocal of the marginal propensity to save, which is always equal to one minus the MPC. If the MPC is $9/10$, the MPS is $1/10$ and the multiplier is 10.

= If the MPC is $4/5$, the MPS is $1/5$ and the multiplier is 5.

= The size of multiplier varies directly with the

Higher ~~bracket~~ the MPC higher will be the multiplier and vice versa.

Formula

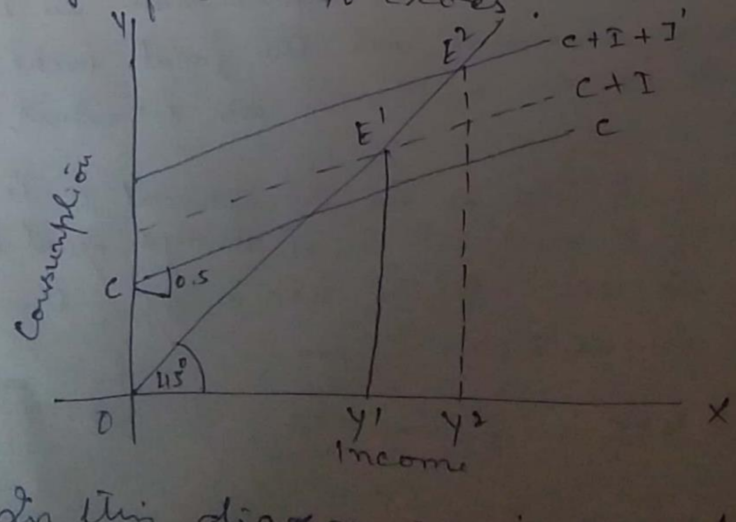
$$K = \frac{1}{1 - \frac{\Delta C}{\Delta Y}}$$, where K stands for multiplier

or

$$K = \frac{1}{MPS}$$

Working of the Multiplier.

Assuming MPC as $\frac{1}{2}$, Multiplier will be 2. An investment of ₹ 20 crores will increase the total income by ₹ 40 crores. When an original investment of ₹ 20 crores is made, half of it will be spent on consumption. ₹ 10 crores out of ₹ 20 crores will be spent on ~~se~~ consumption in the first round. Income ~~will~~ shall increase by ₹ 10 crores, In the second round. In the Third round income shall expand by 5 crores, in the fourth by 2.5 and in the fifth by 1.25 and so on.... adding up to ₹ 40 crores.



In this diagram cc is consumption curve MPC
E'Y' = equilibrium level of income

new curve intersects at E^2

$E^2 Y^2$ gives us the new level of income at Y^2 which is greater Than old level of income $Y1$.

Leakages

1. Saving
2. Debt cancellation
3. Imports
4. Price Inflation
5. Hoarding
6. Purchase of stocks