

Keynesian Theory of Employment

J.M. Keynes in his famous book "The General Theory of Employment, Interest and Money" has given a theory of employment.

- = According to Keynes unemployment occurs due to deficiency in ^{effective} demand, deficiency in consumption and investment. It is also called demand deficiency theory.
 - = Keynes — The turning point of employment Theory is effective demand.
 - = Total employment depends on total demand, and unemployment is the result of deficiency of total demand.
- As employment increases, income increases. The fundamental principle is that as the real income of the community increases, consumption will also increase but by less than income. Therefore, in order to have enough demand to sustain an increase in employment there must be an increase in real investment equal to the gap between income and consumption.

Effective demand

Determined by Two factors

↓
Aggregate Demand Function
(ADF)

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Aggregate Supply Function
(ASF)

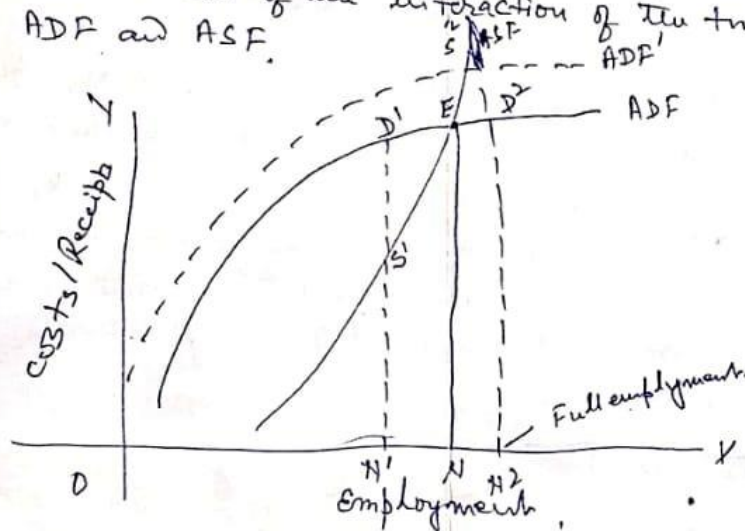
ADF is a schedule of the various amounts - amounts of money which the entrepreneurs in an economy expect from the sale of their output at various levels of employment. (Expectation of receipts)

ASF is a schedule of the various amounts of money which the entrepreneurs in an economy must receive from the sale of output at varying levels of employment.

= ASF thus represents the cost whereas ADF represents the receipts of the entrepreneurs in an economy.

= In ordinary commonsense that the costs must in no case be more than the receipts.

The point of determination of the effective demand as a result of the interaction of the two functions ADF and ASF.



The intersection of the aggregate demand schedule with the aggregate supply schedule determines the actual level of employment in an economy and that at this level of employment, the amount of sale proceeds which the entrepreneurs expect to receive is equal to what they must receive to cover their costs at that level of employment are to be just covered.