

B.A.I

Marginal Efficiency of Capital (MEC)

The MEC in conjunction with the rate of interest determines the amount of new investment, which determines the volume of employment, given the propensity to consume.

- = MEC is equivalent to what is ordinarily called the rate of profit or expected rate of profit.
- = MEC refers to the effectiveness, or rate of return over cost, or profitability of a capital asset.
- = The marginal efficiency of a particular type of capital asset is the highest rate of return over cost expected from producing an additional or marginal unit of that type of asset. The MEC in general is the highest rate of return over cost expected from producing an additional or marginal, unit of the most profitable of all types of capital assets.
- = Thus, MEC is a ratio or ratio of two elements, (1) the expected yields or returns from an income-yielding asset as (2) supply price or replacement cost of the asset which is the source of the prospective yields. Prospective yield is what a business firm expects to obtain from selling the output of its capital assets.

Keynes defines the MEC as being equal to that rate of discount which would make the present value of the series of ~~discount~~ annuities given by the returns expected from the capital asset during its life equal to its supply price. It can be expressed like this:

$$\text{Supply price} = \text{Discounted Prospective Yields}$$

or supply price = $\frac{Q_1}{(1+rm)} + \frac{Q_2}{(1+rm)^2} + \frac{Q_3}{(1+rm)^3} + \dots + \frac{Q_n}{(1+rm)^n}$

The Q_t are the prospective yields in various years 1, 2, 3, and n , and r_m is the MEC, or the rate of discount.

(*) (The values of the Q_t 's are not necessarily the same for each year.)

Factors Affecting MEC

Short ~~run~~ run factors.

1. Nature of demand, prices and cost
2. Propensity to consume.
3. Change in liquid assets.
4. Change in income.
5. current state of expectations.
6. Waves of optimism, pessimism.

Long run factors.

1. Population
2. Development of new Territories.
3. Techniques of production.
4. Supply of capital equipment.
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