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Income Determination Revised Notes

Q16. Explain the components of $S = -a + (1-b) Y$.

Ans. The saving function is $S = -a + (1-b) Y$. In this $(-a)$ represents the intercept term and represents the amount of savings done when there is zero level income. The savings is negative at 0 level as income consumption (a) is positive. Negative saving can be understood as dissaving, which means at 0 level, there is dissaving of amount which is represented by $(-a)$.

The coefficient $(1-b)$ measures the slope of the saving function. The slope of the saving function gives the increase in savings per unit increase in the income. This is known as Marginal Propensity to Save. Since 'b', that is Marginal Propensity to Consume is less than one, it follows that $(1-b)$ i.e. MPS is positive. Saving is an increasing function of income.

Q 17. Can the average propensity to consume be greater than one? Give the reason for your answer.

Ans. Average propensity to consume can be greater than one when the consumption exceeds the income. At that level average propensity to save will be negative. APC will be greater than one if APS is negative. For e.g. if the income is Rs. 1000, the consumption is Rs. 1200, Then $APC = 1200 / 1000 = 1.20$

Q18. Differentiate between ex ante and ex post investment.

Ans. Ex ante is the planned investment which the planner intends to invest at different level of income and employment in the economy. Ex post investment happens when actual sales differ from the planned sales and firms. Thus it face unplanned addition or reduction of inventories.

Q19. Explain the working of a multiplier with an example.

Ans. Multiplier tells us what will be the final change in the income, as a result of change in investment. Change in investment results in the change in income. Symbolically it is presented by:-

$$\Delta I \rightarrow \Delta Y \rightarrow \Delta C \rightarrow \Delta Y$$

The working of a multiplier can be explained with the help of the following table which is based on the consumption that is, $\Delta I = 1000$ and $MPC = 4/5$.

PROCESS OF INCOME GENERATION:-

ROUNDS	ΔI	ΔY	ΔC
1	1000	1000	$4/5 \times 1000 = 800$
2	-	800	$4/5 \times 800 = 640$
3	-	640	$4/5 \times 640 = 512$
4	-	512	$4/5 \times 512 = 409.6$
$\downarrow \infty$	$\downarrow \infty$	$\downarrow \infty$	$\downarrow \infty$
	TOTAL	5000	4000

As per the table

above,

the initial increase in the investment of Rs 1000, there is a total increase in the income by Rs. 5000 as given $MPC = 4/5$. Out of this total increase in the income Rs. 4000 will be consumed and Rs. 5000 be saved.

The sum of total increase in income is also derived as:

$$\Delta y = 1000 + 800 + 640 + 512 + \dots \dots \dots \text{Infinity}$$

$$1000 + 4/5 \times 1000 + (4/5)^2 \times 1000 + (4/5)^3 \times 1000 + \dots \dots \dots \text{infinity}$$

$$= 1000 [1 + 4/5 + (4/5)^2 + (4/5)^3 + \dots \text{infinity}]$$

$$= 1000 [1 / 1 - 4/5] = 1000 \times 5/1 = \text{Rs. 5000 crores.}$$