

Revision Notes for Class 12

Economics (Introductory Macroeconomics)

Chapter 4 Determination of Income and Employment

Aggregate Demand (AD)

Think of it as the total spending in the economy. It's the sum of all the goods and services people, businesses, the government, and foreign buyers are willing to purchase at various price levels. When AD increases, it means more spending and potentially higher prices, and vice versa.

Aggregate Supply (AS)

This is the total amount of goods and services that producers are willing to supply at different price levels. It's about how much the economy can produce. If AS increases, it means the economy is capable of producing more goods and services.

Equilibrium: This is the point where AD and AS match up. At equilibrium, the quantity of goods and services that people want to buy equals the quantity that producers are willing to sell. This balance helps keep prices stable.

Ex Ante

These are forecasts or planned figures made before things happen. For example, ex-ante consumption is the amount of spending consumers plan to do based on their expectations about future income.

Ex Post

This refers to what happens after the fact. For instance, ex-post consumption is the actual spending that occurred once all the factors have played out.

Ex Ante Consumption

Ex Ante Consumption: This is the anticipated spending by consumers. Before making purchases, consumers predict how much they will spend based on their expected income and economic conditions.

Marginal Propensity to Consume (MPC)

Marginal Propensity to Consume (MPC): This is a measure of how much more people will spend when they get an additional dollar of income. For example, if the MPC is 0.8, it means that for every extra dollar earned, 80 cents are spent and 20 cents are saved.

Ex Ante Investment

Ex Ante Investment: This is the amount businesses plan to invest based on their expectations of future profits and economic conditions. It's their forecasted spending on new projects, equipment, or expansion.

Unintended Changes in Inventories

Unintended Changes in Inventories: These occur when there's a mismatch between what businesses expect to sell and what they sell. For instance, if a business is expected to sell 100 units but only sold 80, it will have 20 units more than planned (an unintended increase in inventory). Conversely, if they sold 120 units, they would have 20 units less than planned (an unintended decrease in inventory).

Autonomous Change

Autonomous Change: This is a change in spending or investment that is not influenced by changes in income or other economic factors. For example, a government spending increase due to a new policy would be an autonomous change.

Parametric Shift

This refers to a change in the conditions that affect aggregate demand or supply. For example, if a new technology lowers production costs, it could shift the aggregate supply curve to the right.

Effective Demand Principle

Effective Demand Principle: This principle suggests that the level of output and employment is determined by the level of aggregate demand in the economy. If demand is high, businesses will produce more and hire more workers.

Paradox of Thrift

This concept explains that while saving more money is beneficial for an individual if everyone saves more during a downturn, overall spending decreases. This reduction in aggregate demand can lead to lower income and employment, ultimately reducing total savings.

Autonomous Expenditure Multiplier

Autonomous Expenditure Multiplier: This measures how much additional income is generated from an initial increase in autonomous expenditure (like government spending). For instance, if the government spends more, businesses and consumers might also increase their spending, leading to a multiplier effect on the economy.

Determination of Income

- Income refers to the money earned or received by individuals or businesses, typically regularly, through work, investments, or production activities.
- To calculate national income, you total the incomes earned by individuals, businesses, and the government from various economic activities. Income can also be referred to as output.
- Aggregate demand plays a crucial role in determining income. It encompasses the total demand for final goods, which includes both consumption and investment expenditures.
- Government activities significantly influence aggregate demand. Government spending on goods and services contributes to aggregate demand, similar to the spending by firms and households. However, government-imposed taxes (T) reduce disposable income by taking a portion of income away from households.
- Consequently, national income can be determined by adding together autonomous consumption, autonomous investment, government spending, and induced consumption (after accounting for taxes). This can be expressed as $\text{Income} - \text{Taxes}$.