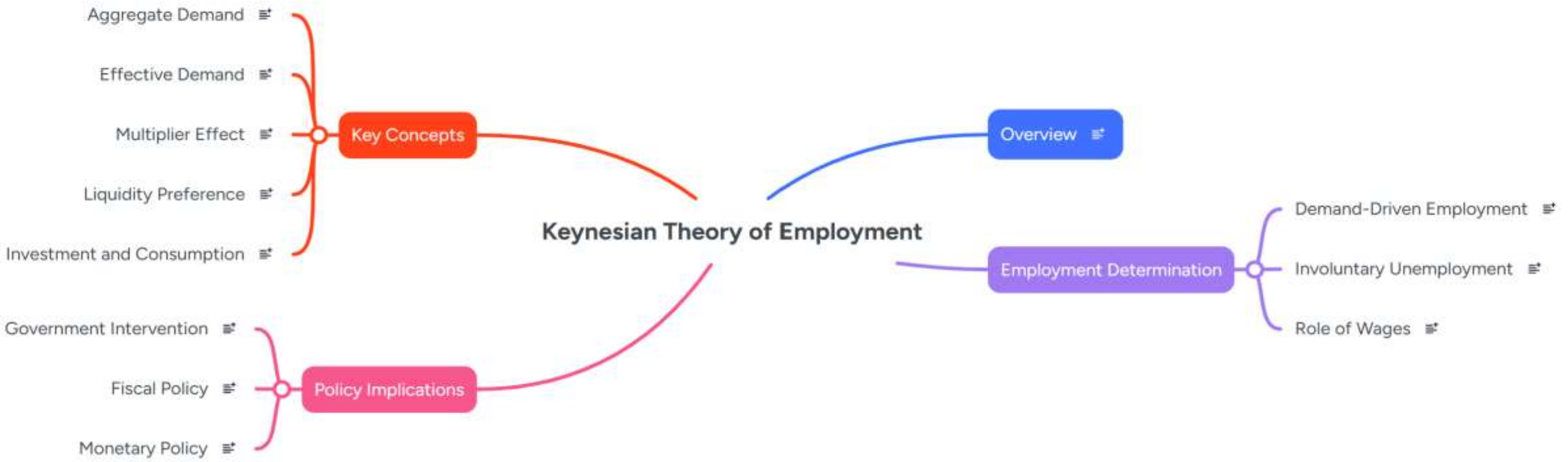


https://www.mindmeister.com/app/map/4010721703

Aggregate demand and equilibrium National income

Effective demand is determined by **aggregate supply function** and **aggregate demand function**.

The level of income and output in an economy is determined by the level of employment. The level of employment is determined by the level of effective demand. Effective demand is revealed by the total expenditure.

Total expenditure= total output + total income

ED = C + I + G

ED = national output = NI = C + I + G

C = consumption expenditure of households

I = investment expenditure of private Enterprises

G = government expenditure on consumption & investment

Higher the Effective demand, Higher is the volume of employment.

To over come unemployment & to increase the level of income effective demand must always increase.

Factors determining Effective Demand

Aggregate supply price

The Aggregate supply function is the minimum amount of sale proceeds required by the entrepreneurs to provide employment and output

Aggregate supply function (ASF) – schedule representing minimum amt of sales proceeds which must be expected to be received by the entrepreneurs from the sales of output resulting from various levels of employment

ASF is an increasing function of the level of employment. **ASF = f (N)**

Aggregate demand function (ADF)

Aggregate demand price - the amt of money which the entrepreneurs expect to receive from sale of output produced at various levels of employment. Aggregate demand price varies with the levels of employment, higher the employment higher is the aggregate demand price

Aggregate demand function (ADF)

The Aggregate demand function is the maximum amount of sale proceeds expected by the entrepreneurs from the sale of output resulting from various alternative levels of employment. **ADF = f (N)**

Schedule of Aggregate Demand Function and Aggregate Supply Function

According to the Keynesian Theory of Effective Demand
In the Keynesian framework, **Effective Demand** is determined at the point where the **Aggregate Demand Function (ADF)** equals the **Aggregate Supply Function (ASF)**.

The equilibrium level of employment and output is obtained at this intersection.

Assumptions
- Employment is measured in number of workers employed.
- Aggregate Demand Price (ADP) = expected sale proceeds from employing a certain number of workers.
- Aggregate Supply Price (ASP) = minimum proceeds required to induce firms to employ that number of workers.

Employment Level (N)	Aggregate Demand Price (ADF)	Aggregate Supply Price (ASF)	comparison	Direction of change in employment
10	120	80	AD > AS	Increases
20	220	160	AD > AS	Increases
30	300	250	AD > AS	Increases
40	360	340	AD > AS	Increases
50	400	400	AD = AS	Under emp equilibrium
60	420	470	AD < AS	decreases
70	430	560	AD < AS	decreases

- When employment increases from 10 to 40 workers, Aggregate Demand exceeds Aggregate Supply, encouraging firms to increase employment and production.

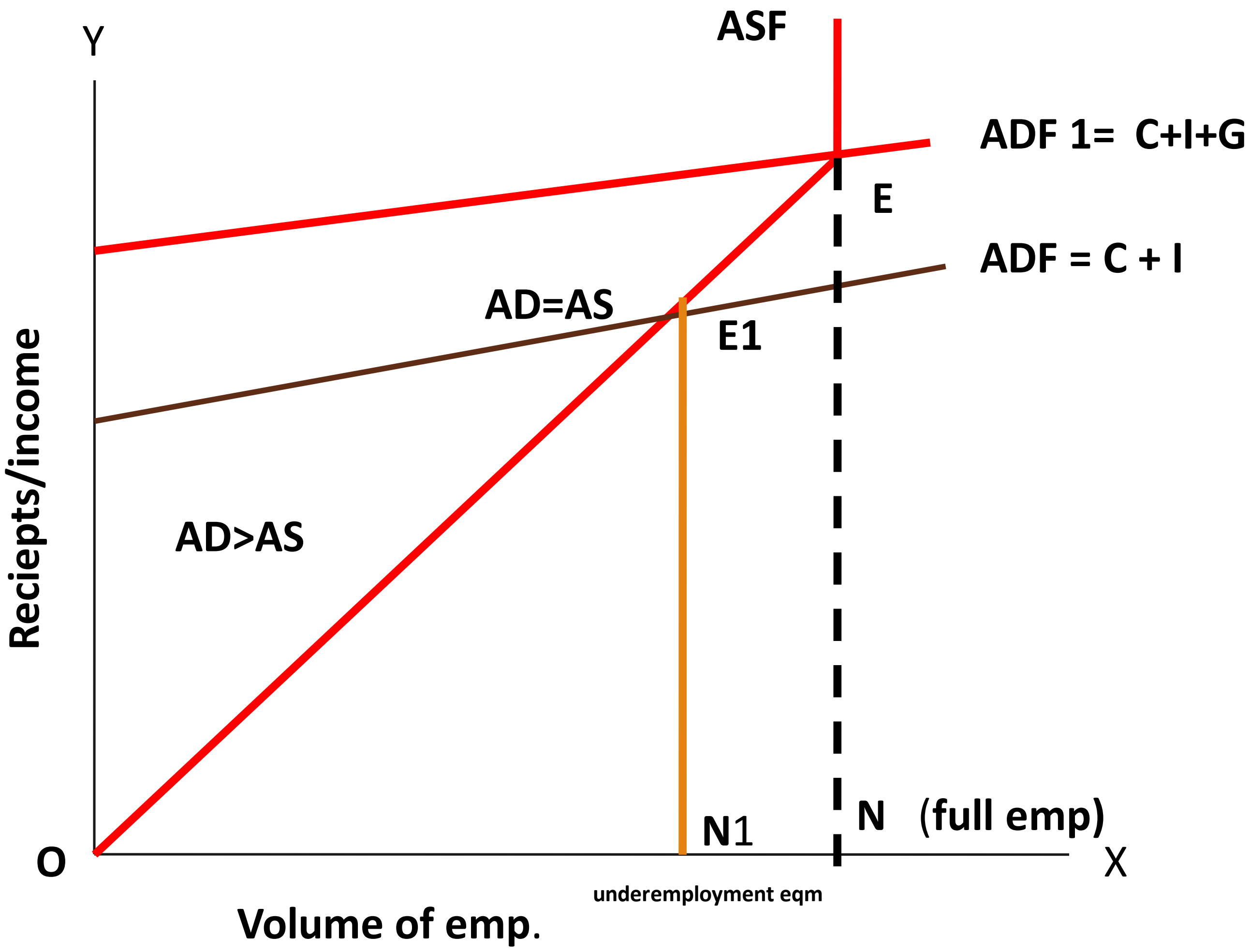
- At **50 workers**, Aggregate Demand Price equals Aggregate Supply Price.

$$\mathbf{ADF = ASF}$$

- This point represents the **Point of Effective Demand** and determines the equilibrium level of employment and output in the economy.

- Beyond 50 workers, Aggregate Supply > Aggregate Demand,
- meaning producers do not expect sufficient proceeds to justify additional employment.

- Thus, according to John Maynard Keynes, equilibrium may occur even before full employment, leading to **underemployment equilibrium**.



Point of effective demand

Importance / significance of Keynesian ED principle

1. Unemployment. Is the result of deficiency in ED. It is the ED that determines the level of employment in the economy
2. ED principle rejects the Say's law of markets
3. The two imp components of ED are consumption and investment (C + I)
4. Deficiency of demand results in recession and depression in a market economy
5. Dillard has said that Keynes's theory manifests on the paradox of " poverty in the midst of plenty "
6. A highly developed economy experiences deficiency of low APC, which increases the gap between Y and C. hence huge investment exp is needed to fill the gap and employment
7. Keynesian theory suggests that the demand deficiency can be removed by government expenditure