GEC S2-01

Introduction to Economic Theory - II

SEMESTER - II

ECONOMICS

BLOCK - 2

KRISHNA KANTA HANDIQUI STATE OPEN UNIVERSITY

Subject Experts

1. Professor Srinath Baruah, V.C., KKHSOU
2. Professor Madhurjya P. Bezbaruah, Dept. of Economics, G.U.
3. Dr. Nissar A. Barua, Dept. of Economics, G.U.
4. Dr. Ratul Mahanta, Dept. of Economics, G.U.

Course Co-ordinator : Bhaskar Sarmah, KKHSOU

SLM Preparation Team

Units	Contributors	Editors
6	**Dr. Gautam Mazumdar**	***Content:***
	Cotton University, Guwahati	**Professor K. Alam** (Retd.), Gauhati Univ.
7,8	**Dr. Parag Dutta**	**Dr. Gautam Mazumdar**
	Dispur College, Guwahati	Cotton University, Guwahati.
9	**Bidisha Mahanta Hazarika**	***Language:***
	Doomdooma College	**Dr. Debajit Das,** Dakshin Kamrup College, Mirza
10	**Bhaskar Sarmah**, KKHSOU	**Himangshu Barman,** D. K. College, Mirza
		Structure, Format & Graphics:
		Bhaskar Sarmah, KKHSOU

July, 2017.

© Krishna Kanta Handiqui State Open University

This Self Learning Material (SLM) of the Krishna Kanta Handiqui State Open University is made available under a Creative Commons Attribution-NonCommercial-ShareAlike4.0 License (international): http://creativecommons.org/licenses/by-nc-sa/4.0/

Printed and published by Registrar on behalf of the Krishna Kanta Handiqui State Open University.

The University acknowledges with thanks the financial support provided by the **Distance Education Bureau, UGC** for the preparation of this study material.

Headquarters: Patgaon, Rani Gate, Guwahati - 781017
City Centre: Housefed Complex, Dispur, Guwahati - 781006; Web : www.kkhsou.in

CONTENTS

		Pages
UNIT 6:	**The Keynesial Theory of Employment** Aggregate Demand and Aggregate Supply Functions; Basic Framework of Keynesian Theory; The Principle of Effective Demand; Determination of Equilibrium Level of National Income; Aggregate Expenditure - Aggregate Output Identity	**79-95**
UNIT 7:	**Determination of Interest Rate: Keynesian Approach** Keynesian Approach to Demand for Money: Transaction Demand for Money, Precautionary Demand for Money, Speculative Demand for Money, Bulls and Bears; Liquidity Preference Theory of Determination of Interest Rate	**96-107**
UNIT 8:	**Keynesian Consumption Function** Income-Consumption Relationship; Fundamental Psychological Law of Consumption; Average Propensity to Consume and Marginal Propensity to Consume: Significance of APC and MPC, Relation between APC and MPC; Factors Influencing Consumption Spending: Subjective Factors affecting the Consumption Function, Objective Factors affecting the Consumption Function	**108-123**
UNIT 9:	**Concept of Multiplier & Derivation of Investment Multiplier** Concept of Multiplier; Algebraic Derivation of the Investment Multiplier; Working of the Multiplier; Assumptions of Multiplier; Leakages of Multiplier; Criticisms of Multiplier and Its Importance; Relevance of Multiplier in a Under-developed Countries	**124-141**
UNIT 10:	**Investment Function and MEC** Investment: Basic Concepts: Meaning of Investment, Gross Investment vs Net Investment, Induced Investment vs Autonomous Investment; Factors affecting the Investment Function: Marginal Efficiency of Capital (MEC), Rate of Interest, Marginal Efficiency of Investment (MEI), Distinction between MEC and MEI; Relation between Rate of Interest, MEC and Volume of Investment	**142-154**

COURSE INTRODUCTION

This is the second block of the course entitled as “Introduction to Economic Theory-II” of the BA second semester programme in Economics. Like the first block of the course, this second block also comprises five units. The first unit of the block which is the *sixth unit* of the course is actually a continuation of the fifth unit, i.e., the last unit of the previous block. In this unit, the Keynesian approach to employment has been discussed. Thus, in this unit, the Keynesian concepts of aggregate demand and aggregate supply functions has been discussed. Similarly, the basic framework of Keynesian theory, particularly, the Principle of Effective Demand has been discussed. Finally, the determination of equilibrium level of national income has been discussed. The *seventh unit* is on the Keynesian approach to determination of interest rate. In this unit, the Keynesian approach to demand for money, particularly the concepts of transaction demand for money, precautionary demand for money, speculative demand for money has been discussed. Apart from these, the concepts of bulls and bears and the liquidity preference theory of determination of interest rate have also been discussed. The *eighth unit* is on the Keynesian consumption function. In this unit, the relationship between income and consumption has been discussed. Apart from this, one of the foundations of the Keynesian approach, i.e., the Fundamental Psychological Law of Consumption, the concepts of average propensity to consume and marginal propensity to consume, their significance and relationships have been discussed. Finally, the factors that affect the consumption function has been dealth with. The *ninth unit* deliberates on the concept of multiplier and the derivation of investment multiplier. In this unit, the concept of multiplier and the algebraic derivation of the investment multiplier have been discussed. Similarly, the working of the multiplier, its assumptions and leakages, and its importance and relevance in the under-developed countries have also been discussed. The last unit of the block is on investment function and and MEC. In this unit, basic concepts of investment, viz., its meaning, distinctions between gross investment and net investment, and induced Investment and autonomous investment have been dicussed. Other than that, the factors affecting the investment function, particularly, marginal efficiency of capital (MEC), rate of interest, marginal efficiency of investment (MEI) have also been dealt with. Finally, the distinction between MEC and MEI and the relation between rate of interest, MEC and the volume of investment have been discussed.

This block includes some along-side boxes to help you know some of the difficult, unseen terms. Some “ACTIVITY’ have been included to help you apply your own thoughts. And, at the end of each section, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your progress of study. It will be better if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with “ANSWERS TO CHECK YOUR PROGRESS” given at the end of each unit.