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TOPIC:- THE MULTIPLIER ANALYSIS

The theory of multiplier has an important place in the modern theory of income and employment. The concept of multiplier initially developed by Prof. F. A. Kahn in the early 1930s. Prof. Kahn developed the concept of multiplier with reference to the increase in employment, direct as well as indirect, as a result of original increase in investment and income from employment. Keynes, however, propounded the concept of multiplier with reference to the increase in total income, direct as well as indirect, as a result of original increase in investment and income. On the basis of above analysis, Prof. Kahn's multiplier is known as 'employment multiplier' whereas Prof. Keynes's multiplier is known as 'investment or income multiplier.

Multiplier analysis explains what happens to circular flow of economic life when the behaviour of one of the sectors or components of aggregate demand - consumption, investment government spendings or net exports - changes spontaneously. The multiplier analysis states that in a market economy any autonomous change in real planned demand for output leads to a cummulative reaction in the equilibrium level of production that is some multiple of the autonomous change that made it expand. The process of multiplier is nothing but the working out of this cummulative response through a definite sequence of actions and reactions among the various sectors of circular flow. The aggregate of the cummulative reaction in output and income relative to the autonomous change in demand is the 'multiplier number'. Hence, multiplier refers to the fact that an autonomous increase or decrease of expenditures for output can increase or decrease total spending for output by some multiple by inducing a change of consumption spending in the same direction. In simple terms, the multiplier is the ratio of the change in income to the initial change in expenditures or injections that brought it about. Under the analysis of multiplier theorem, the mathematical formula of multiplier can be written in following manner :-

$$K = \frac{\Delta Y}{\Delta J}$$

Here, K represents to multiplier and ΔY and ΔJ represent change in income and change in expenditures respectively.

Assumptions of multiplier theory :-

Following are the assumptions of multiplier theory :-

(I) The marginal propensity to consume remains constant throughout as the income increases in various rounds of consumption expenditure.

(II) There is a net increase in investment in a period and no further induced effects on investment in that period occur.

(III) There is no any time-lag between the increase in investment and the resultant increment in income.

(IV) Excess capacity exists in the consumer goods industries.

(V) During analysis of multiplier process, the concept of closed economy exists.