Date ___/___/______ Page No.: 1

Date :- 29/4/2020	Degree Part-II (Hons)
Content Writer :-	Paper - III
Dr. Abhay Kumar Pathak	Content of the Paper
Deptt. of Economics,	Macro Economics
Marwari College,	Module :- 6
Darbhanga (LNMU)	

TOPIC :- THE ACCELERATOR THEORY

The multiplier theory considers only the effect of initial investment upon aggregate income, through changes in consumption outlay. But induced consumption may, in turn, induce further investment. Such an effect is known as acceleration principle or the accelerator.

The acceleration theory shows how the demand for capital goods changes as the result of changes in the demand for consumption goods, and explains how a change in the output of consumption goods causes an expansion in the production of capital goods used in making those consumption goods.

Since the production of any given amount of final output usually requires an amount of capital several times larger than the output produced with it during any short period, any increase in final demand for output, will give rise to an additional demand for capital goods several times larger than the new final consumption demand, so that changes in the demand for consumption goods are transmitted with an increasing intensity to the demand for capital goods. Thus, the demand for capital goods is a derived demand. The acceleration principle has been, therefore, also described as the "magnification of derived demand."

Acceleration Coefficient:-

A change in investment outlay causes a change in the rate of consumption expenditure by an amount equal to the acceleration coefficient. This ratio between the net change in consumption expenditure and the induced investment is called acceleration coefficient. Symbolically,

$$a = \frac{\Delta I}{\Delta C},$$ where a stands for acceleration coefficient, ΔI for net change in investment outlays, and ΔC for net change in consumption outlays.

Technically, the value of acceleration coefficient depends upon the capital-output ratio and the durability of capital goods. The greater the durability of capital equipment and the higher the capital-output ratio, the greater will be the acceleration effect.

Limitations of the Acceleration Principle:-

Following are the limitations of acceleration theory:-

(1) In a dynamic economy, the capital-output ratio does not remain constant as assumed. Thus, the acceleration effect will be different at different times.

(II) There should be no excess capacity in the capital goods sector. Otherwise, the increase in demand for consumption goods may be better by utilisation of existing machinery rather than by investing new ones.

(III) The change in consumption demand is assumed to be permanent and not of a temporary type. Otherwise, entrepreneurs will not invest in additional capital goods so required, and acceleration will not materialise.

(IV) Resources are assumed to be elastic so that investment in new capital goods can be undertaken easily. If the economy is operating near full employment level, there may not be sufficient factors or resources available to expand capital goods industries and, to that extent, the acceleration effect will be limited.

(V) Money supply, especially credit, is assumed to be elastic so that funds for induced investment are easily available. If there is a shortage of funds, the rate of interest will be very high.

Significance of Accelerator Theory:—

Since the acceleration principle indicates how a given change in consumption results in a change in

Date __/__/____

the level of investment, we can understand the process of income generation and propagation more clearly. The theory of acceleration further explains why fluctuations in income and employment occur rather violently. Thus, this doctrine demonstrates that the capital goods industries fluctuate much more than consumption goods industries. Induced investment is very much useful in explaining the upper turning point of a cycle, for what is necessary for a fall in the volume of induced investment is not any absolute fall in the demand for consumption goods but only a decline in its rate of interest increases.

However, the acceleration theory by itself, is incapable of explaining the cyclical variations in income and employment. For a complete analysis of the process of income propagation, we must consider both the multiplier and the accelerator effect together.