Q5. Measure the level of ex-ante aggregate demand when autonomous investment and consumption expenditure (A) is Rs 50 crores, and MPS is 0.2 and level of income (Y) is Rs 4000 crores. State whether the economy is in equilibrium or not (cite reasons).

Ans. Consumption expenditure (A) = Rs 50 Crores

MPS = 0.2

So, MPC = 1 – MPS

= 1 – 0.2

= 0.8

Y = 4000 Crores

We know that AD = A + cY .... (1)

Putting the values in equation .... (1)

AD = 50 + 0.8 x 4000

= 50 + 3200

= Rs 3250 Crores

But, Rs 3250 < Rs 4000

Implies that AD < Y

Hence, the economy is not in equilibrium.

Q6. Explain 'Paradox of Thrift'.

Ans: Paradox of thrift refers to a situation in which people tend to save more money, thereby leading to a fall in the savings of the economy as a whole. In other words, when everyone increases his/her saving-income proportion i.e. MPS (s), then, the aggregate demand will fall as consumption decreases. This will further lead to a decrease in employment and income level and finally this will reduce the total savings for the economy. This concept was suggested by Keynes wherein increased saving at individual levels will gradually lead to the slowdown of economy in terms of circular flow of income.

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