

Meaning of effective demand:

In economics, demand for goods and services does not merely mean the desire or willingness to buy them. The consumers must also have the capacity to buy. The demand in fact denotes the effective desires involving both the willingness and capacity to buy. The term 'effective demand' refers to the aggregate amount spent on goods and services by the whole community in a specified period. Thus effective demand signifies the total spending of community.

According to Kuwihara, "Total demand is effective when consumption plus investment assumes a value equal to income."

The above definition suggests that effective demand is determined by total expenditure.

$$\text{Effective demand} = \text{Total Expenditure} \dots \dots \textcircled{i}$$

If total expenditure increases, there is an increase in effective demand and vice-versa. In economic system, one man's expenditure is another man's income so that aggregate expenditure remains equal to aggregate income.

$$\text{Total Expenditure} = \text{Total Income} \dots \dots \textcircled{ii}$$

The total income in a country remains equal to the value of total output. As output rises, there is also rise in income and vice-versa.

$$\text{Total Income} = \text{Total Output} \dots \dots \textcircled{iii}$$

The level of output in a country is determined by the volume of employment. At a higher level of employment,

The output too is larger and vice-versa.

$$\text{Total Output} = \text{Total Employment} \quad \text{(iv)}$$

From (i), (ii), (iii) and (iv) it follows that

$$\text{Effective Demand (ED)} = \text{Total Expenditure (E)}$$

$$= \text{Total Income (Y)}$$

$$= \text{Total Output (O)}$$

$$= \text{Total Employment (N)}$$

$$E.D = E = Y = O = N$$

Thus the inference follows that the level of effective demand is the determinant of employment.