Dr.Surendra Kumar Class-M.A.Sem-IV

Kaldor model is illustrated by following system of equations:

$Y = W + P$; $I = S$; $S = S_w + S_p$,
where Y is the national income ; W—the income of labour (wages) ; P—the income of entrepreneurs (profit) ; I—investment ; S—saving ; S_w—saving from wages ; S_p—saving from profits.
But $S_w = S_w W$ and $S_p = S_p P$
where S_w is the share of saving from wages ; and S_p is the share of savings from profit, substituting for S, we get:

$$\begin{aligned} I &= s_p P + s_w W && (\because I = S) \\ &= s_p P + s_w (Y - P) && (\because W = Y - P) \\ &= s_p P + s_w Y - s_w P \\ &= (s_p - s_w) P + s_w Y \end{aligned}$$

Dividing by Y both sides, we get :

$$\frac{I}{Y} = (s_p - s_w) \frac{P}{Y} + s_w$$

Dividing again both sides by $(s_p - s_w)$, we get :

$$\frac{I}{Y} \times \frac{I}{(s_p - s_w)} = \frac{P}{Y} + \frac{s_w}{(s_p - s_w)}$$

or

$$\frac{P}{Y} = \frac{I}{s_p - s_w} \cdot \frac{I}{Y} - \frac{s_w}{s_p - s_w}$$

where P/Y is the share of profit in the total income and I/Y is the investment income ratio, Now, we can easily see and appreciate Kaldor's thesis. His thesis is that the share of profit in the total income is a function of the ratio of investment to income (I/Y).

In the above equation, it can easily be seen that an increase in the income-investment ratio (I/Y) will result in

an increase in the share of profits out of total income (P/Y), as long as it is assumed that both s_w and s_p are constant and further that s_p is greater than ($s_p > s_w$). Thus, given the mps, of wages earners (s_w) and the mps of entrepreneurs (s_p)$_1$ the share the profits (P) in the national income (Y), that is P/Y depends on the ratio of investment (I) to total income or output (Y), that is I/Y. In other words, P/Y is a function of

$\frac{I}{Y}$, i.e., $\left[\frac{P}{Y} - f\left(\frac{I}{Y}\right)\right]$.

Of greater importance to us is the underlying economic rationale for Kaldor's theorem that the share of profit in the total income (P/Y) is a function of the investment-income ratio (I/Y). Under full employment conditions an increase in investment must in real terms, bring about an increase in both the ratio of investment to income (I/Y) and also an increase in the savings income ratio (S/K). This is necessary if equilibrium at a higher level of real investment is to be obtained.