John Richard Hicks (1904 - 1989)

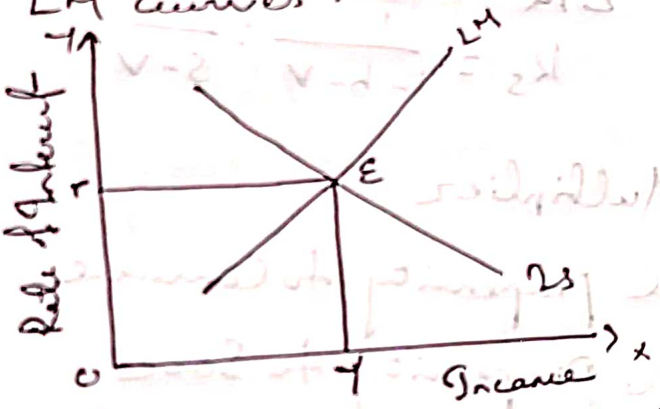
J.R. Hicks was one of the most important and influential economists of the 20th century.

He was rewarded the Nobel prize in Economics in 1972 together with Kenneth Arrow for their pioneering contributions to general economic equilibrium theory and welfare theory.

① IS-LM Model

- It summarised the Keynesian view of macroeconomics.
- He described the economy as a balance between three commodities: money, consumption and investment.
- IS curve is a negatively sloping curve showing different level of income at different rates of interest and this relationship between the rate of interest and income is determined by the equality of saving and investment.
- LM curve is positively sloping curve showing different level of incomes at different level of interest determined by equality of demand and supply of money.

The equilibrium rate of interest and the equilibrium level of income are determined by the intersection of IS and LM curves.



Thus, the determinants of the rate of interest along with the level of income are: saving function, investment function, liquidity preference function and the quantity of money.

Keynes's theory of employment contained all these four elements but he could not combine them to develop a general equilibrium system.

(2) Super - Multiplier

In his book: A contributions to the Theory of Trade cycle (1950), combined multiplier and accelerator mathematically and called it super-multiplier.

Total income (Y) is equal to the total consumption (C) plus total investment (I).

$$Y = C + I$$

Total investment I again divided into two parts: autonomous investment I_a and Induced investment I_i.

$$Y = C + I_a + I_i$$

$$\Delta Y = b\Delta Y + \Delta I_a + V\Delta Y$$

$$\Delta Y - b\Delta Y - V\Delta Y = \Delta I_a$$

$$\Delta Y(1-b-V) = \Delta I_a$$

$$\frac{\Delta Y}{\Delta I_a} = \frac{1}{1-b-V} = \frac{1}{S-V}$$

$$K_s = \frac{1}{1-b-V} = \frac{1}{S-V}$$

K_s: Super Multiplier

b: Marginal propensity to Consume

S: Marginal propensity to Save

V: Marginal propensity to invest or $\Delta I/\Delta Y$.

Super multiplier tells that total income in the economy will increase by K_s times the initial increase in the autonomous investment.

$$\Delta Y = \frac{1}{1-b-V}\Delta I_a$$

$$\Delta Y = K_s \Delta I_a$$

(3) Trade Cycle Theory:

Hicks utilised his concept of super-multiplier to explain the dynamics of business cycle. According to him, business fluctuations are generated by autonomous investment and induced investment through multiplier and acceleration respectively.

(4) New Definition of Consumer Surplus:

He defined consumer's surplus as the sum of money which must either be paid to or taken away from the consumer, after some change has taken place in his position, in such a way so as to leave his total satisfaction unaffected.

(5) Welfare:

Hicks developed his famous 'compensation' criteria called Kaldor-Hicks efficiency welfare criteria in 1939. While Kaldor evaluates compensation from the point of view of gainers, Hicks evaluates compensation from the view of losers. Thus, Hicks criterion is simply the reverse test of the original Kaldor one for an increase in real social welfare.

Kaldor-Hick criteria states that: The state of the economy A is considered socially preferable to state B if those who would have lost from A cannot profitably bribe the gainers into to not make the change from B to A.

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