

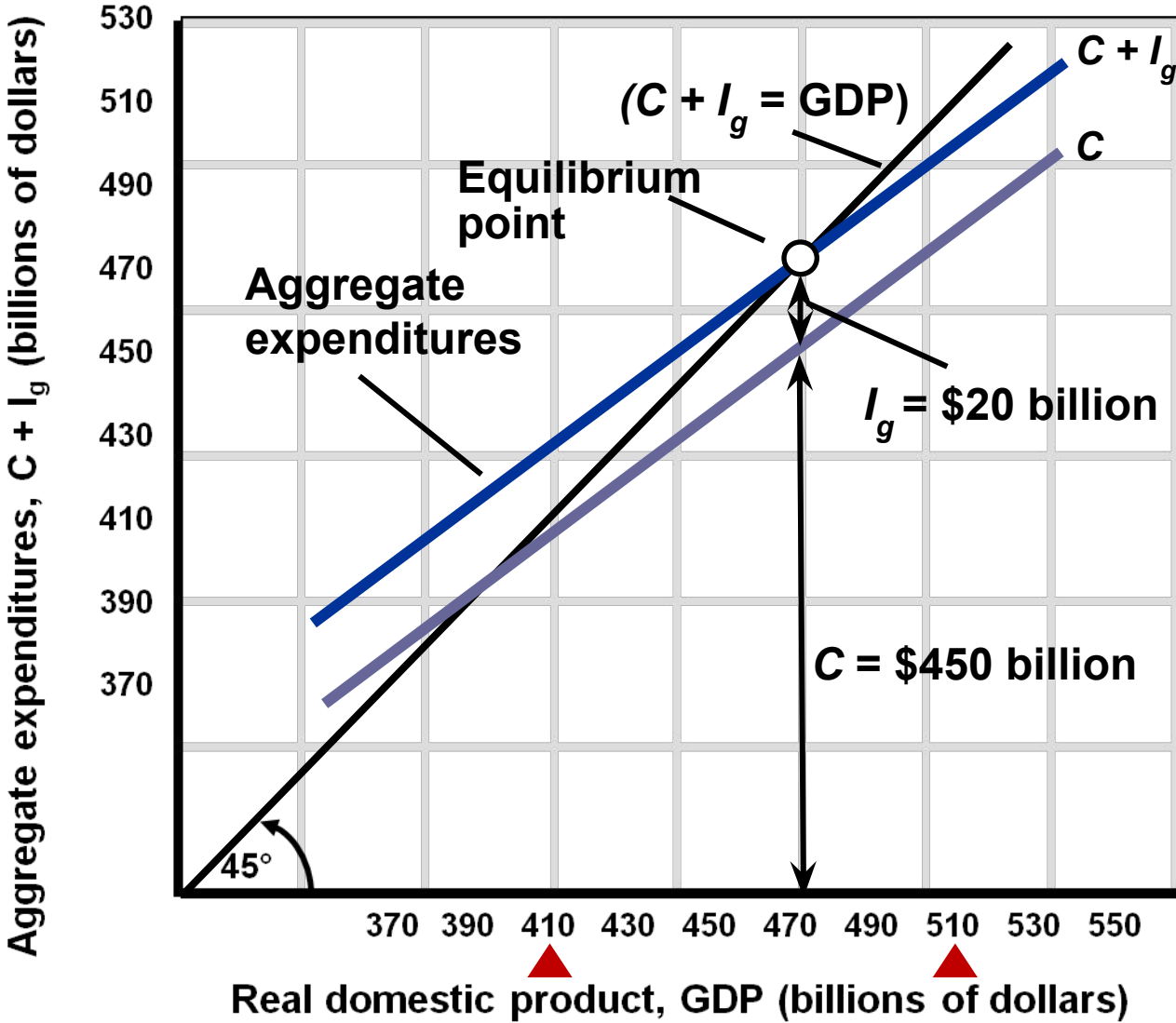
28

The Aggregate Expenditures Model

Assumptions and Simplifications

- Use the Keynesian aggregate expenditures model
- Prices are fixed
- $GDP = DI$
- Begin with private, closed economy
 - Consumption spending
 - Investment spending

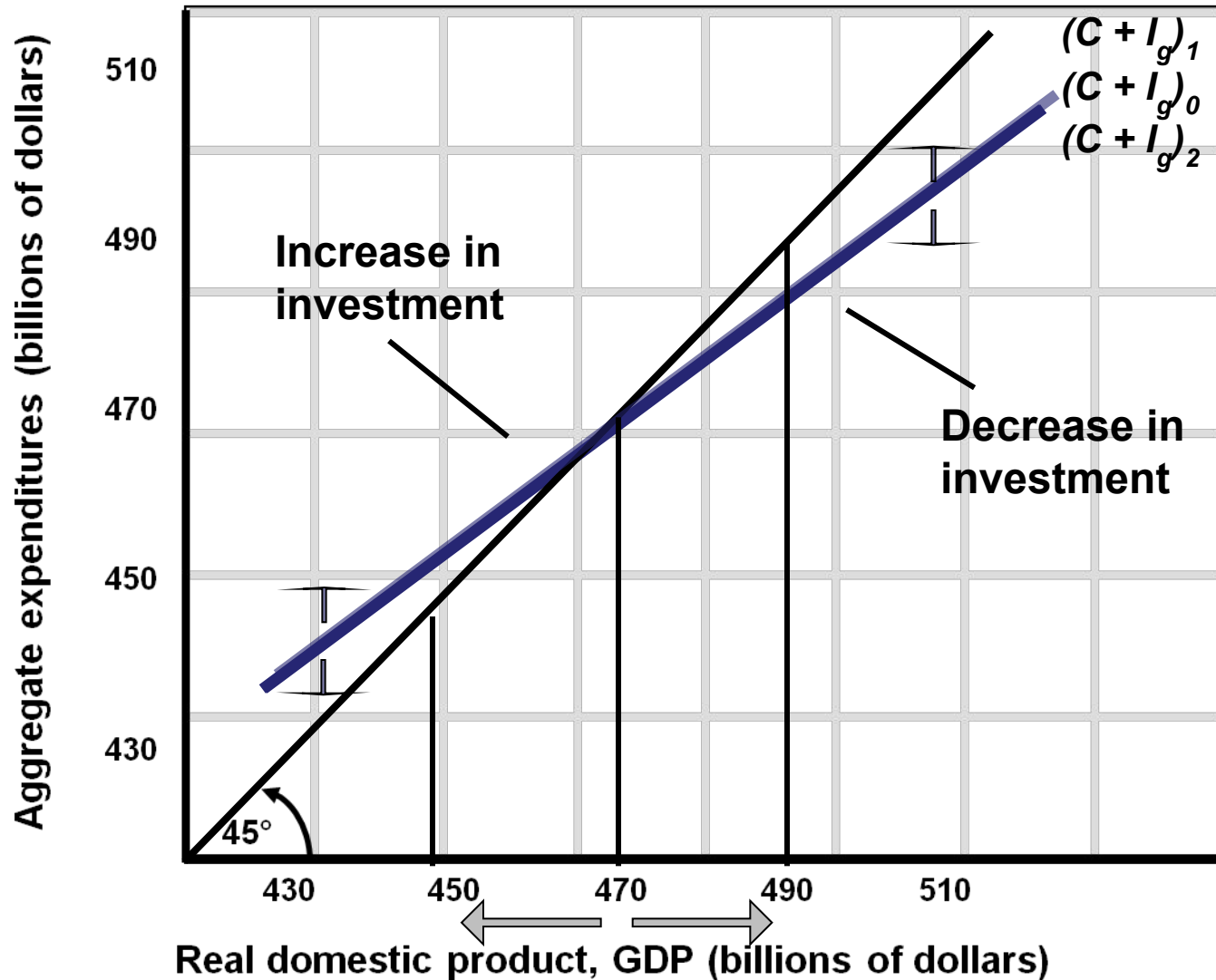
Equilibrium GDP



Other Features of Equilibrium GDP

- Saving equals planned investment
 - Saving is a leakage of spending
 - Investment is an injection of spending
- No unplanned changes in inventories
 - Firms do not change production

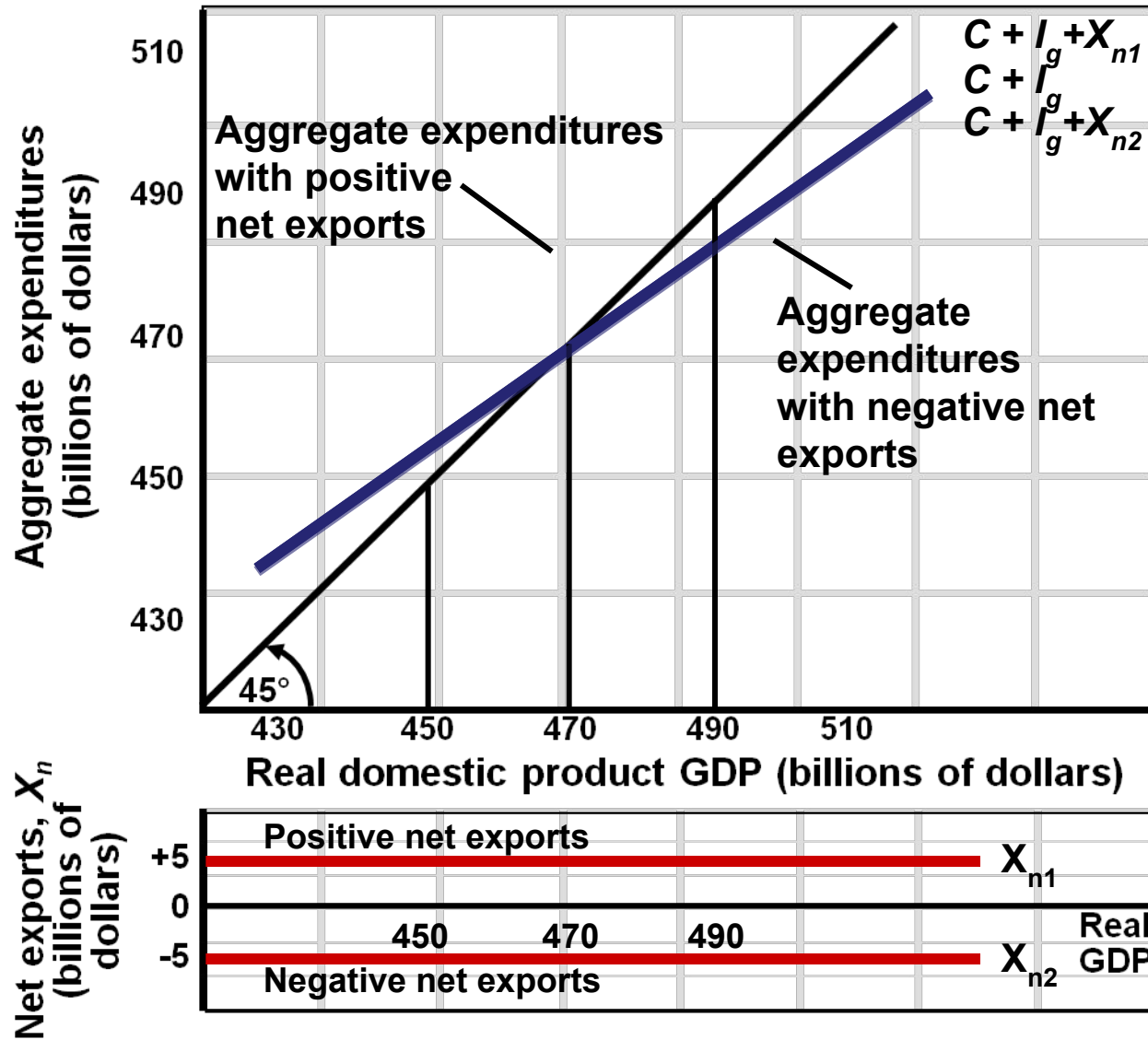
Changes in Equilibrium GDP



Adding International Trade

- Include net exports spending in aggregate expenditures
 - Private, open economy
- Exports create production, employment, and income
- Subtract spending on imports
- X_n can be positive or negative

Net Exports and Equilibrium GDP



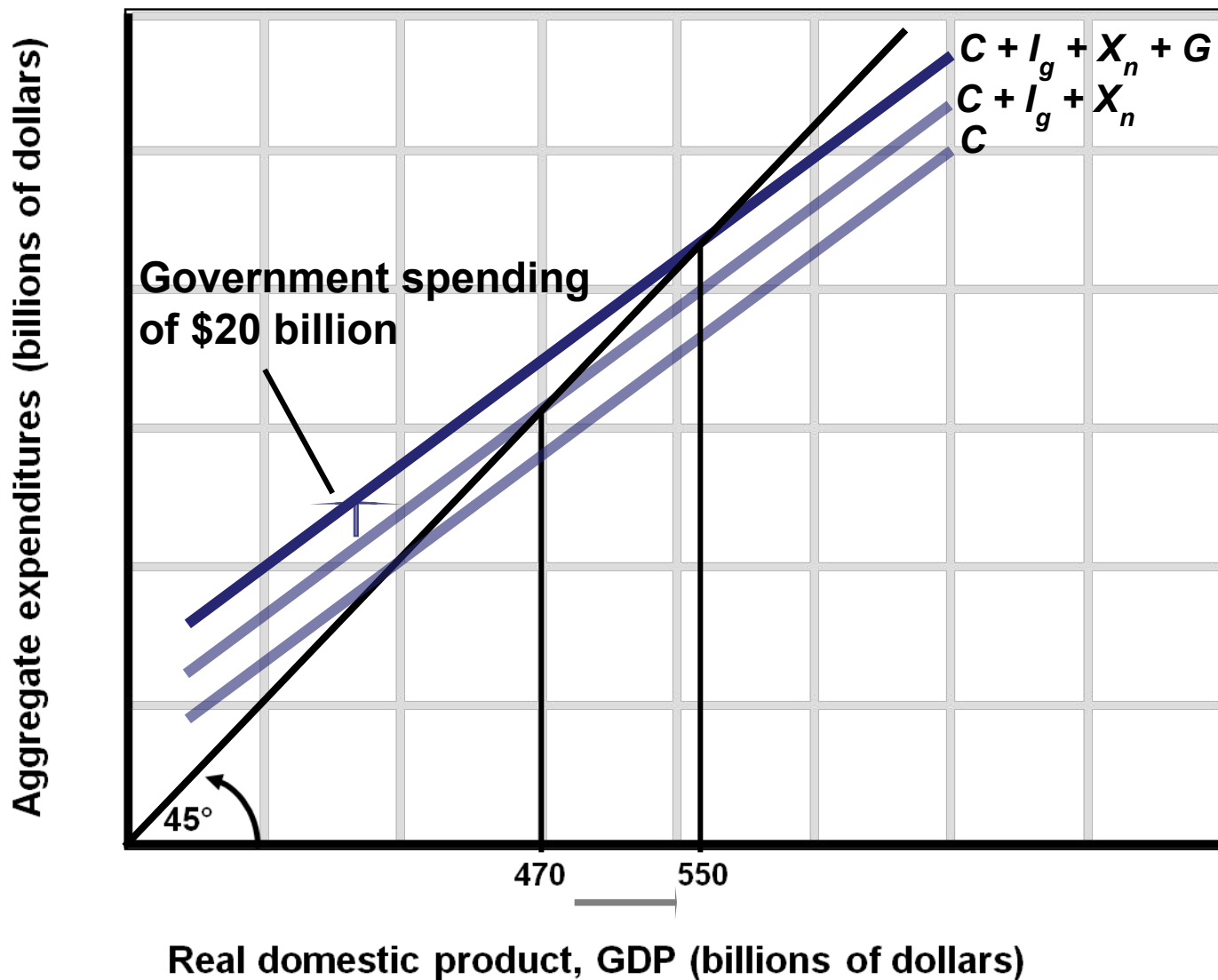
International Economic Linkages

- Prosperity abroad
 - Can increase U.S. exports
- Exchange rates
 - Depreciate the dollar to increase exports
- A caution on tariffs and devaluations
 - Other countries may retaliate
 - Lower GDP for all

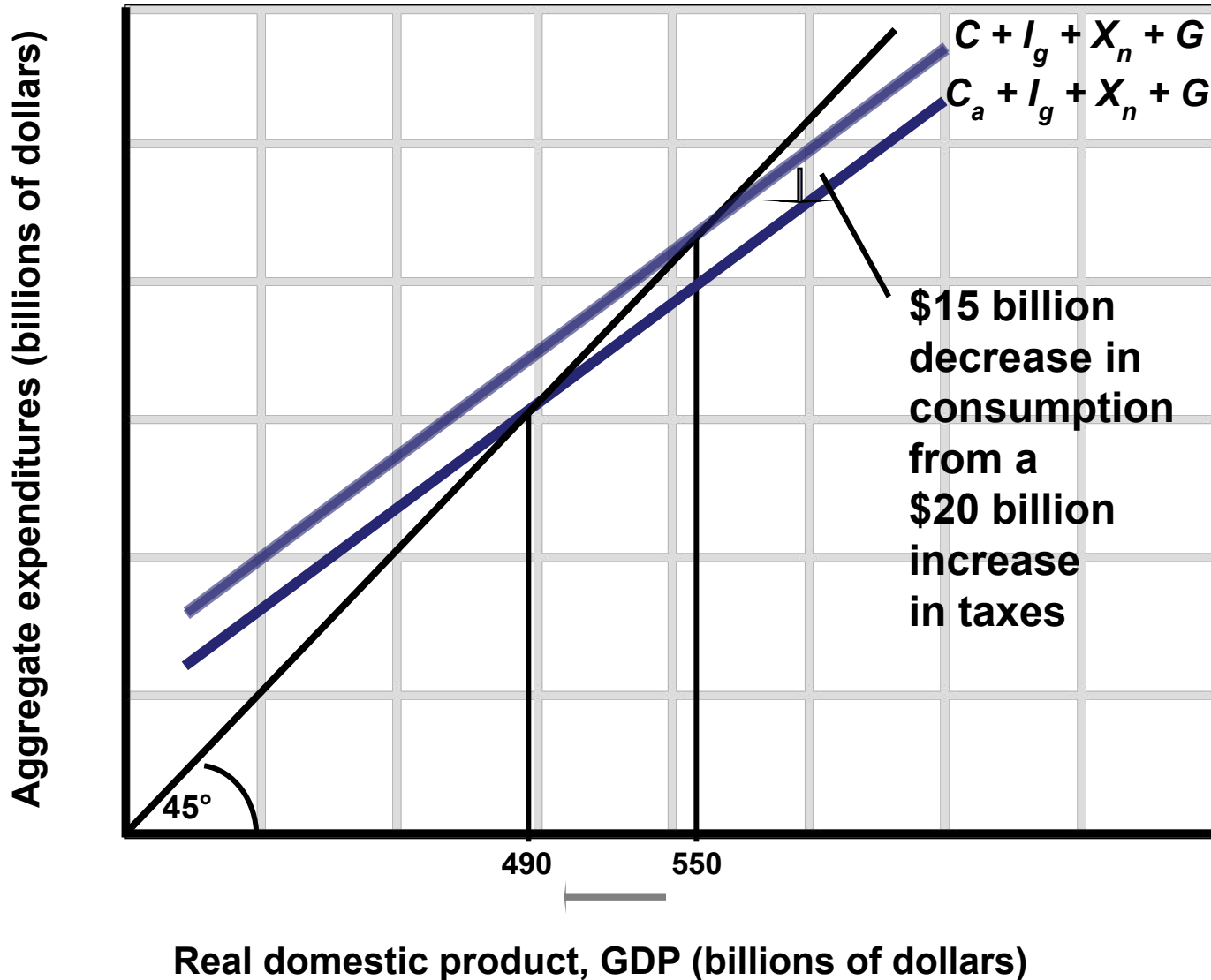
Adding the Public Sector

- Government purchases and equilibrium GDP
 - Government spending is subject to the multiplier
- Taxation and equilibrium GDP
 - Lump sum tax
 - Taxes are subject to the multiplier
 - $DI = GDP$

Government Purchases and Eq. GDP



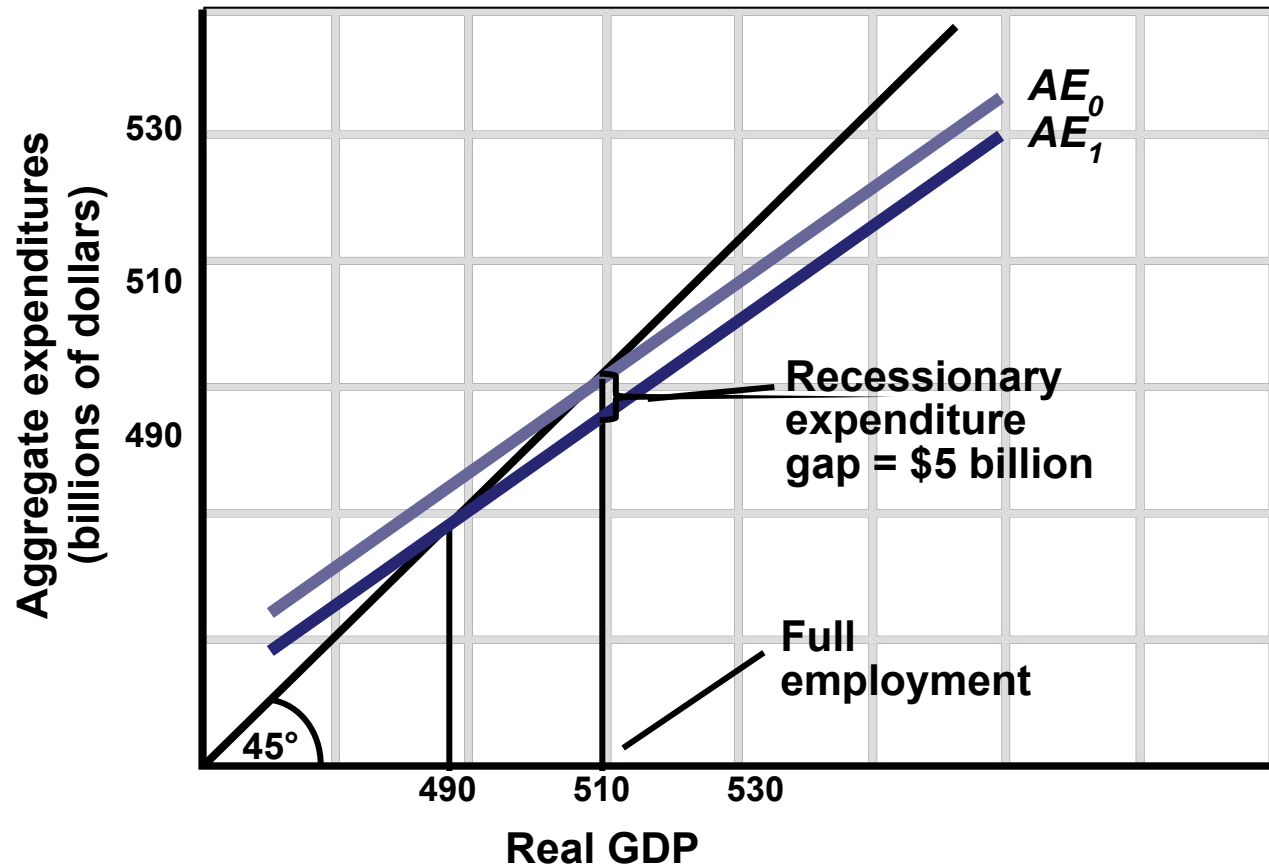
Taxation and Equilibrium GDP



Equilibrium versus Full-Employment

- Recessionary expenditure gap
 - Insufficient aggregate spending
 - Spending below full-employment GDP
 - Increase G and/or decrease T
- Inflationary expenditure gap
 - Too much aggregate spending
 - Spending exceeds full-employment GDP

Equilibrium versus Full-Employment



(a)
Recessionary expenditure gap

Equilibrium versus Full-Employment

