Keynesian Equilibrium

This activity is designed to give you practice with manipulations of the aggregate expenditure model. It shows you how the expenditure schedule is derived and how it helps to determine the equilibrium level of income. This activity assumes that the price level is constant with the consumer price index or price level having a value of 100. All numbers in Figure 19.1 are in billions of constant dollars.

Figure 19.1
Income-Expenditure Schedule

Income (Output)	Consumption Spending	Investment Spending	Government Spending	Total Spending (Aggregate Expenditure)
$2,400	$2,500	$300	$100	
2,600	2,600	300	100	
2,800	2,700	300	100	
3,000	2,800	300	100	
3,200	2,900	300	100	
3,400	3,000	300	100	
3,600	3,100	300	100	
3,800	3,200	300	100	

1. Use the data on consumption spending and income to draw the consumption function on the graph in Figure 19.2. Label the function C.

2. Using the consumption function you have just drawn and the data on investment and government spending, draw the aggregate expenditure schedule on the same graph. Label it AE (C + I + G). What is the difference between the aggregate expenditure schedule and the consumption function?

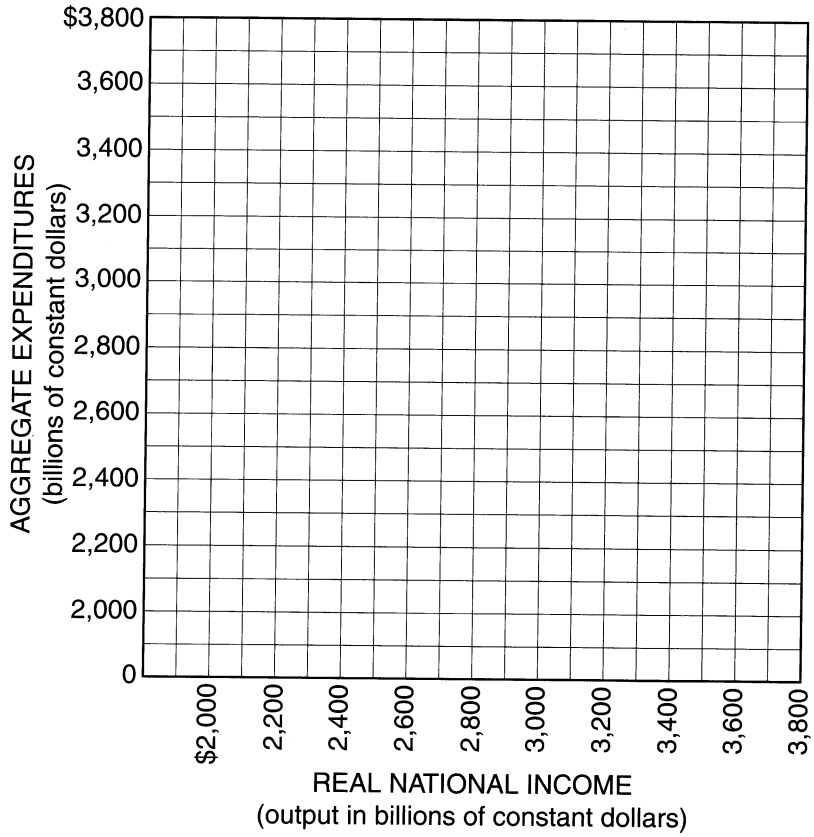
3. Now draw a line representing all the points at which total spending and income could be equal. Label this the 45° line.

4. The 45° line represents all the points that *could be* the equilibrium level of total spending. Now circle the one point that *is* the equilibrium level of total spending. What is the equilibrium level of total spending on your graph? _____

Adapted from William J. Baumol and Alan S. Blinder, *Economics, Principles and Policy,* 3rd ed. (New York: Harcourt Brace & Company, 1985), p. 55. James Chasey, Homewood-Flossmoor High School, Flossmoor, Ill., contributed to this activity.

Figure 19.2

Aggregate Expenditure Model



5. Based on the data in Figure 19.1, and assuming that the full-employment level of total spending is $3,600 billion, what conclusions can you draw about the equilibrium level of total spending?

6. Based on the data in Figure 19.1, and assuming that the full-employment level of total spending is $3,200 billion, what conclusions can you draw about the equilibrium level of total spending?

7. If government spending increased by $100 billion, what would be the new equilibrium level of total spending? _____ For the increase of $100 billion in government spending, total spending increased by _____. Explain why this occurs.