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LESSON NOTES

Worksheet 9

Subject: Economics

Year / Level: 13

Name: _____

Strand	3 - Macroeconomics
Sub Strand	Investigate how an economy operates and functions to achieve its economic growth.
Content Learning Outcome	Explore the Keynesian model of determining income.

INCOME AND EXPENDITURE ANALYSIS

- ❖ **Keynes** believed that there are two major factors that **determine** the national **income** of a country. These two factors are **Aggregate Supply** (AS) and **Aggregate Demand** (AD) of goods and services. In addition, he believed that the equilibrium level of national income can be estimated when $AD=AS$.
- ❖ This model assumes that the aggregate supply curve is perfectly elastic up to the full employment level of output after which it becomes perfectly inelastic.
- ❖ Hence, price level, until the full employment level, will be determined solely by the height of the supply curve. The price level gets less attention while the entire focus is on the determination of equilibrium level of income, which is determined solely by the aggregate demand.

Aggregate Demand – refers to the quantity of national output that is purchased at a given price and represents the total demand of the economy.

Thus Aggregate Demand (AD) = $C+I+G+(X-M)$

Component of AD	Symbol	Description in national account
Consumption spending	C	Final consumption expenditure: private.
Investment spending	I	Gross fixed capital formation .
Government spending	G	Final consumption expenditure: Government.
Export receipts	X	Export of goods and services.
Import payments	M	Import of goods and services.
Gross domestic payment	GDP	Expenditure on gross domestic product.

Consumption- there are two types:

1. **Autonomous consumption**- the amount necessary for survival. This consumption takes place even if there is no income.
2. **Induced consumption**- consumption that varies with income. Higher the income, higher is the **consumption**.

Investment-there are two types:

1. **Intended investment /gross fixed capital formation**-value of investment goods made in the economy. Net fixed capital formation includes all new capital goods minus depreciation.

2. **Unintended investment/unintended disinvestment**- this includes all changes in stock.

Note: Induced Investments- means increase in expenditure on capital goods in times of increasing national income and decreasing investment with fall in national income.

Government- all spending by government on goods and services including both operating and capital expenditures E.g. Government build new schools, paying salaries to civil servants.

Net exports- export receipts minus import payments.

Economic Stability –

occurs when there is an absence of big swings in prices, output and jobs.

The Income and expenditure analysis mostly deals with **aggregate supply** represented by **45 line**, **aggregate demand** and **components of Aggregate demand**.

Activity

1. The marginal propensity to save is defined as
 - A. savings divided by disposable income.
 - B. disposable income divided by savings.
 - C. change in disposable income divided by change in savings.
 - D. change in savings divided by change in disposable income.
2. Which of the following is the best example of unintended investment?
 - A. the pre-selling of retail space in a new shopping mall.
 - B. the purchase of new railway rolling stock from overseas.
 - C. the building of a new factory in Tavua town for an overseas company.
 - D. a furniture manufacturer overestimates demand and has more stock on hand.

SHORT ANSWER QUESTIONS

A. Use the information given below and your knowledge to answer the questions that follows. Consider an economy with the following characteristics. All variables are measured in millions of dollars

$$C=40+0.75Y$$

$$I = 20$$

$$G=25$$

$$X=30$$

$$M= 10+0.1 Y$$

- i. Calculate the value equilibrium level of real GDP (2marks)

- ii. Calculate the change in GDP if government spending increased by \$5m. (2marks)

- iii. What does the slope of the consumption function measure? (1mark)

B. Use the following data to complete the sentences below(all figures are in \$b)

Y	C+I+G	X	M
250	310	65	25
300	340	65	30
350	370	65	35
400	400	65	40
450	430	65	45
500	460	65	50
550	490	65	55

- i. The equilibrium level of income is \$_____b.
- ii. At equilibrium ,the level of spending on domestic goods and services is \$_____b
- iii. At income \$300 b ,the level of net exports is \$_____b

(3marks)