Econ 98-Chiu **Keynesian-Cross Worksheet** **Spring 2005**

Name & SID: Date:

Assumptions are critical in macroeconomics. Different assumptions change dramatically your answers. Assume the following conditions for the following questions:

- No government spending (G=0)
- Closed economy (NX=0)
- Prices are fixed (inflation=0)
- Nominal and real interest rates are fixed
- Planned investment is autonomous of interest rates (I=constant)
- Y refers to real GDP (not nominal)

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1. What is the difference between an *identity*, *behavioral relationship*, and *equilibrium relationship*? Give an example of each.

2. What is the difference between aggregate output and aggregate income?

3. What are the two components of investment spending?

4. What is the major determinant of consumption spending (C)?

5. What are the components of consumption spending?

6. Define marginal propensity to consume (mpc).

7. What is planned aggregate expenditure (PAE)?

8. How is planned aggregate expenditure different from aggregate expenditure?

9. Define the equilibrium relationship between aggregate output and planned aggregate expenditure (as an equation).

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10. Draw the Keynesian-cross (Y=PAE) model. Label your aggregate output line, Y=PAE. Label your planned aggregate expenditure line, PAE. Label the equilibrium GDP, Y_1.

11. What happens when $Y_2 > Y_1$?

12. What happens when $Y_3 < Y_1$?

13. What is controversial about these adjustment mechanisms?