

- The Keynesian aggregate expenditure model is a simple model of the economy and shows the multiplied effect that changes in government spending, taxes and investment can have on the economy.
- The marginal propensity to consume (MPC) is the additional consumption spending from an additional dollar of income. The marginal propensity to save (MPS) is the additional savings from an additional dollar of income.
- The marginal propensity to consume and the marginal propensity to save are related by $MPC + MPS = 1$. In the simple model, an additional dollar of income will either be consumed or saved.
- The multiplier is a number that shows the relationship between changes in autonomous spending and maximum changes in real gross domestic product (real GDP).
- In a simple model, the formula for calculating the multiplier is

$$\text{Income expenditure multiplier} = \frac{1}{1 - MPC} = \frac{1}{MPS}$$

- The multiplier effects result from subsequent rounds of induced spending that occur when autonomous spending changes.
- Investment and its response to changes in the interest rate are important in understanding the relationship between monetary policy and GDP.
- Aggregate demand (AD) and aggregate supply (AS) curves look and operate much like the supply and demand curves used in microeconomics. However, these macroeconomic AD and AS curves depict different concepts, and they change for different reasons than do microeconomic demand and supply curves. AD and AS curves can be

used to illustrate changes in real output and the price level of an economy.

- The downward sloping aggregate demand curve is explained by the interest rate effect, the wealth effect and the net export effect. The wealth effect is also called the real-balance effect.
- The aggregate supply curve can be divided into three ranges: the horizontal range, the upward sloping or intermediate range, and the vertical range.
- Shifts in aggregate demand can change the level of output, the price level or both. The determinants of aggregate demand include consumer spending, investment spending, government spending, net export spending and money supply.
- Shifts in aggregate supply can also change the level of output and the price level. The determinants of AS include changes in input prices, productivity, the legal institutional environment and the quantity of available resources.
- In the short run, economists think that equilibrium levels of GDP can occur at less than, greater than or at the full-employment level of GDP. Economists believe that long-run equilibrium can occur only at full employment.
- In a dynamic aggregate demand and aggregate supply model of the economy, changes in wages and prices over time induce the economy to move to the long-run equilibrium.
- Fiscal policy consists of government actions that may increase or decrease aggregate demand. These actions involve changes in government expenditures and taxation.
- The government uses an expansionary fiscal policy to try to increase aggregate demand during a recession. The government may

- decrease taxes, increase spending or do a combination of the two.
- The government uses a contractionary fiscal policy to try to decrease aggregate demand when the economy is overheating. The government may increase taxes, decrease spending or do a combination of the two.
 - A change in output can also be illustrated by the Keynesian aggregate expenditure model. This model differs from the AD and AS model because in the Keynesian model the price level is assumed to be constant.
 - The AD and AS model can be reconciled with the Keynesian expenditure model. In the horizontal range of the AS curve, both models are identical. The models differ in the intermediate and vertical ranges of the AS curve.
 - Autonomous spending is that part of AD that is independent of the current rate of economic activity.
 - Induced spending is that part of AD that depends on the current level of economic activity.
 - Discretionary fiscal policy means the federal government must take deliberate action or pass a new law changing taxes or spending. The automatic or built-in stabilizers change government spending or taxes without new laws being passed or deliberate action being taken.
 - Stagflation, when the economy simultaneously experiences inflation and unemployment, can be explained by a decrease in aggregate supply.