Macro Theory
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Model 2

*The Depression Model***

Goods Market Only

1. Consumption — $C = a + b*Yd$ $\quad 0 < b < 1, \; a > 0$

2. Disposable Income — $Yd = Y - T$

3. Aggregate Demand — $AD = C + Ip + G + NX$
(Ip = planned investment)

4. Goods Market Equilibrium — $Y = AD$

Endogenous Variables	**Exogenous Variables**
C, Yd, AD, Y	T, Ip, G, NX

** This model is also called the income-expenditure model. It applies only to economies with income (Y) less than potential income (Yp).

Extensions

i) Endogenous Taxes $\quad T = t0 + t1*Y$ with
$0 < t1 < 1$
where taxes are income taxes net of transfer payments.

ii) Add real wealth [net worth NW] to the consumption function

$C = a + b*Yd + d*NW$
with b and $d > 0$
Note: Since prices are fixed in this model, nominal values = real values.

iii) Endogenous net exports $\quad NX = eX - im_0 - im_1*Yd$
with im_0 and $im_1 > 0$