Chapter 11- Spending, Output, and Fiscal Policy

* **Menu costs-** the costs of changing prices
* **Planned Aggregate Expenditure (PAE)-** total planned spending on final goods and services

$$PAE=C+I^{P}+G+NX$$

* **Consumption function-** the relationship between consumption spending and its determinants, in particular, disposable income

$$C=\overbar{C}+\left(mpc\right)\left(Y-T\right)$$

where $\overbar{C}$ is autonomous consumption, mpc is the marginal propensity to consume, and (Y-T) is disposable income

* **Autonomous consumption-** consumption spending that is not related to the level of disposable income
* **Wealth effect-** the tendency of changes in asset prices to affect households’ wealth and thus their consumption spending
* **Marginal propensity to consume (mpc)-** the amount by which consumption rises when disposable incomes rises by $1; we assume that 0 < mpc < 1
* **Autonomous expenditure-** the portion of planned aggregate expenditure that is independent of output
* **Induced expenditure-** the portion of planned aggregate expenditure that depends on output Y

$$Example:PAE=960+0.8Y$$

autonomous expenditure is 960

induced expenditure is 0.8Y

* **Expenditure line-** a line showing the relationship between planned aggregate expenditure and output
* **Short run equilibrium output-** the level of output at which output Y equals planned aggregate expenditure PAE; the level of output that prevails during the period in which prices are predetermined

$$Short run equilibirum output is Y=PAE or Y-PAE=0$$

* **Income expenditure multiplier-** the effect of a one-unit increase in autonomous expenditure on short-run equilibrium output

$$m= \frac{1}{1-mpc}$$

* **Stabilization policies-** government policies that are used to affect planned aggregate expenditure, with the objective of eliminating output gaps
* **Expansionary policies-** government policy actions intended to increase planned spending and output
* **Contractionary policies-** government policy actions designed to reduce planned spending and output
* **Fiscal policy-** decisions about how much the government spends and how much tax revenue it collects
* **Automatic stabilizers-** provisions in the law that imply automatic increases in government spending or decreases in taxes when real output declines