10.15: Putting It Together- The Income-Expenditure Model

In this module we examined Keynesian economics in more detail using the Income-Expenditure Model. This model was the original graphical representation of Keynesian economics, and while not as widely used as the AD-AS model, it has several advantages over the latter. These include: 

- It fleshes out the components of aggregate demand (or total expenditure) than can be done with the AD-AS model
- It provides a more intuitive, algebraic approach for determining macroeconomic equilibrium and analyzing shocks to macro equilibrium
- It allows for a better graphical and algebraic understanding of the expenditure model.

At the beginning of this module, we asked, "What caused the Great Recession of 2007-2008 and why was it so serious?" The answer comes directly from the Income-Expenditure model. The recession was the result of a collapse in the housing market, which lead to large decline in investment expenditures beginning with investment in residential structures. The recession proved to be so serious, because of the large decrease in investment expenditure combined with the cumulative effects of the expenditure multiplier. GDP didn't just fall; it fell by several times the decrease in investment expenditure.