

8.2: Aggregate Demand for Goods and Services

Learning Objective

1. Learn that aggregate demand is the summation of the separate demands for each variable in the national income identity.

The Keynesian model of aggregate demand for goods and services is developed by identifying key determinants of demand for the national output. When we talk about *aggregate* demand (AD), it means demand by households, businesses, and the government for anything and everything produced within the economy. The starting point is the national income identity, which states that

$$GNP = C + I + G + EX - IM,$$

that is, the gross national product is the sum of consumption expenditures, investment expenditures, government spending, and exports minus imports of goods and services.

We rewrite this relationship as

$$AD = C^D + I^D + G^D + EX^D - IM^D,$$

where the left side, AD , refers to aggregate demand for the GNP and the right-side variables are read as consumption demand, investment demand, and so on. Determinants of the right-side variables will be considered in turn.

It is important to remember that demand is merely what households, businesses, and the government “would like” to purchase given the conditions that exist in the economy. Sometimes demand will be realized, as when the economy is in equilibrium, but sometimes demand will not be satisfied. On the other hand, the variable Y , for real GNP, represents the aggregate supply of G&S. This will correspond to the actual GNP whether in equilibrium or not.

Next, we’ll present the determinants of each demand term: consumption, investment, government, and export and import demand.

Key Takeaways

- In the G&S model, aggregate demand for the GNP is the sum of consumption demand, investment demand, government demand, and current account demand.

exercise

1. **Jeopardy Questions.** As in the popular television game show, you are given an answer to a question and you must respond with the question. For example, if the answer is “a tax on imports,” then the correct question is “What is a tariff?”
 - In the G&S model, the variable Y stands for this.
 - In the G&S model, the variable AD stands for this.
 - In the G&S model, the variable I^D stands for this.
 - In the G&S model, the variable EX^D stands for this.
 - In the G&S model, the variable CA^D stands for this.

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