

8.5: Government Demand

Learning Objective

1. Learn the determinants of government demand and the effects of changes in these variables.

Government demand refers to the government's demand for goods and services produced in the economy. In some cases this demand is for G&S produced by private businesses, as when the government purchases a naval aircraft. Other government demand is actually produced by the government itself, as what occurs with teachers providing educational services in the public schools. All levels of government demand—federal, state, and local—are included in this demand term. Excluded are transfer payments such as social insurance, welfare assistance, and unemployment compensation.

In this model, government demand is treated the same way as investment demand: it is assumed to be exogenous. This means that its value is determined outside of the model and is not dependent on any variable within the model. A simple equation for government demand can be written as

$$G^D = G_0,$$

where the “0,” or naught, subscript on the right side indicates that the variable is exogenous or autonomous. In words, the equation says that government demand is given exogenously as G_0 .

This is a more common assumption in many other macro models, even though one could argue dependencies of government demand on GNP and interest rates. However, these linkages are not likely to be as strong as with investment, thus assuming exogeneity here is a more realistic assumption than with investment.

key takeaway

1. In the G&S model, government demand is assumed to be exogenous, meaning not dependent on any other variable within the model such as GNP or interest rates.

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?”
 - These three levels of government demand are included in G^D in the G&S model.
 - This type of government expenditure is not included in G^D in the G&S model.
 - Of *exogenous* or *endogenous*, this describes government demand in the G&S model in the text.
 - An expenditure by a state school system on teachers' salaries would represent demand recorded in this component of aggregate demand in the G&S model.

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