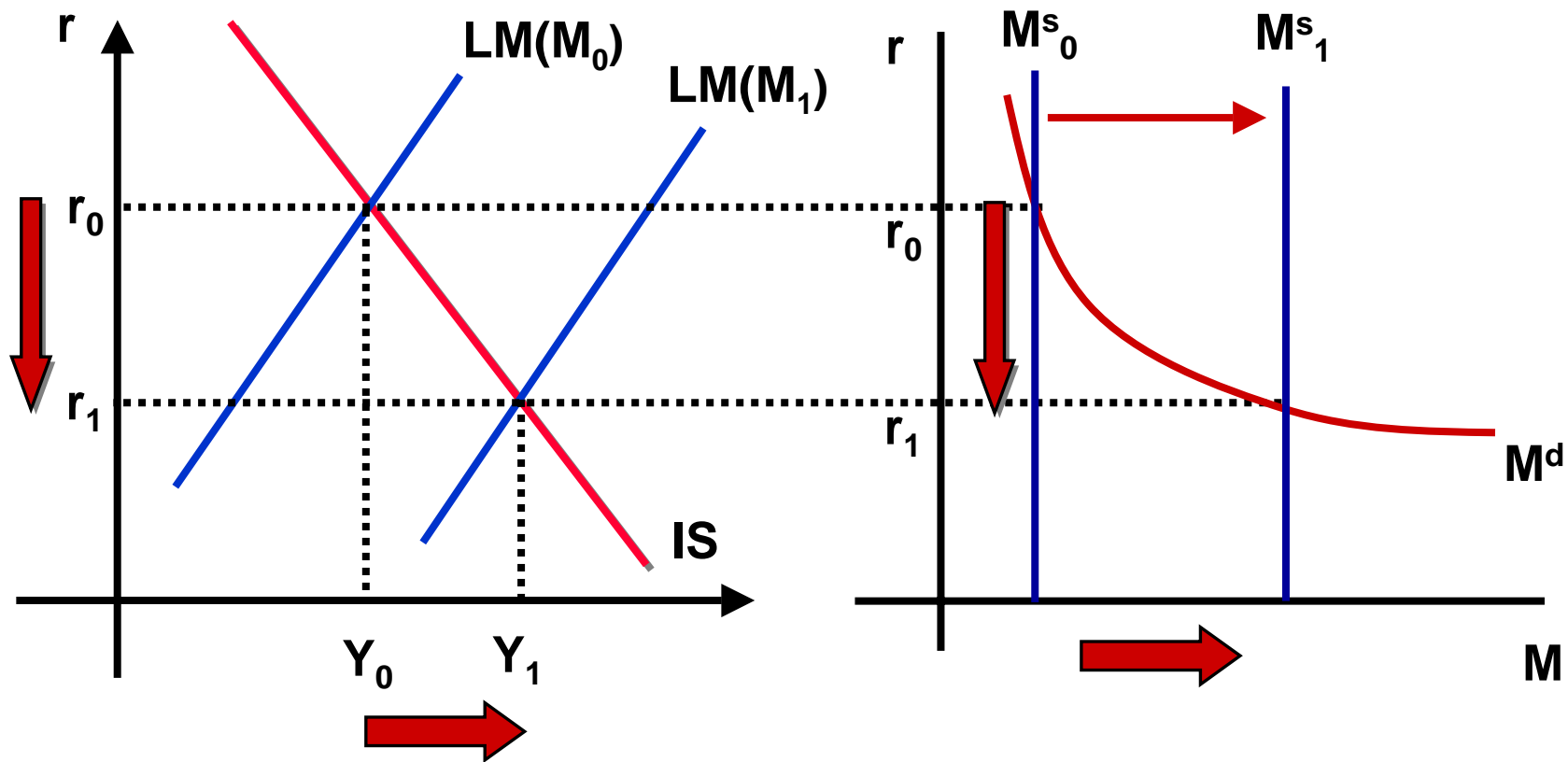


# The Keynesian System III: Policy Effects in the IS-LM Model

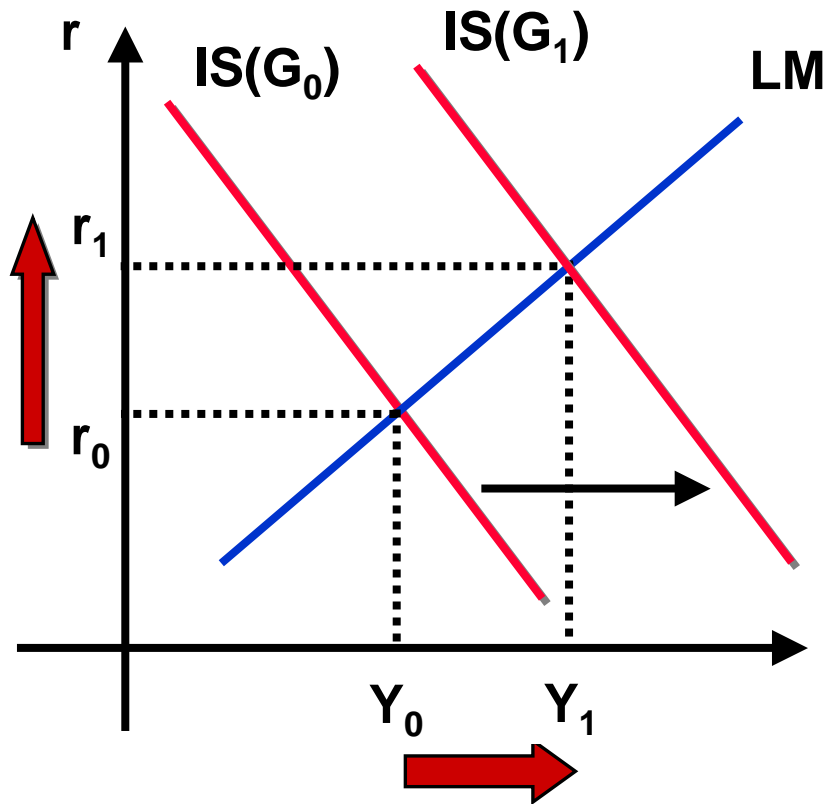
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Professor Steve Cunningham  
Graduate Macroeconomics I  
ECON 309

# Increasing the Money Supply



# Increase in Gov't Spending



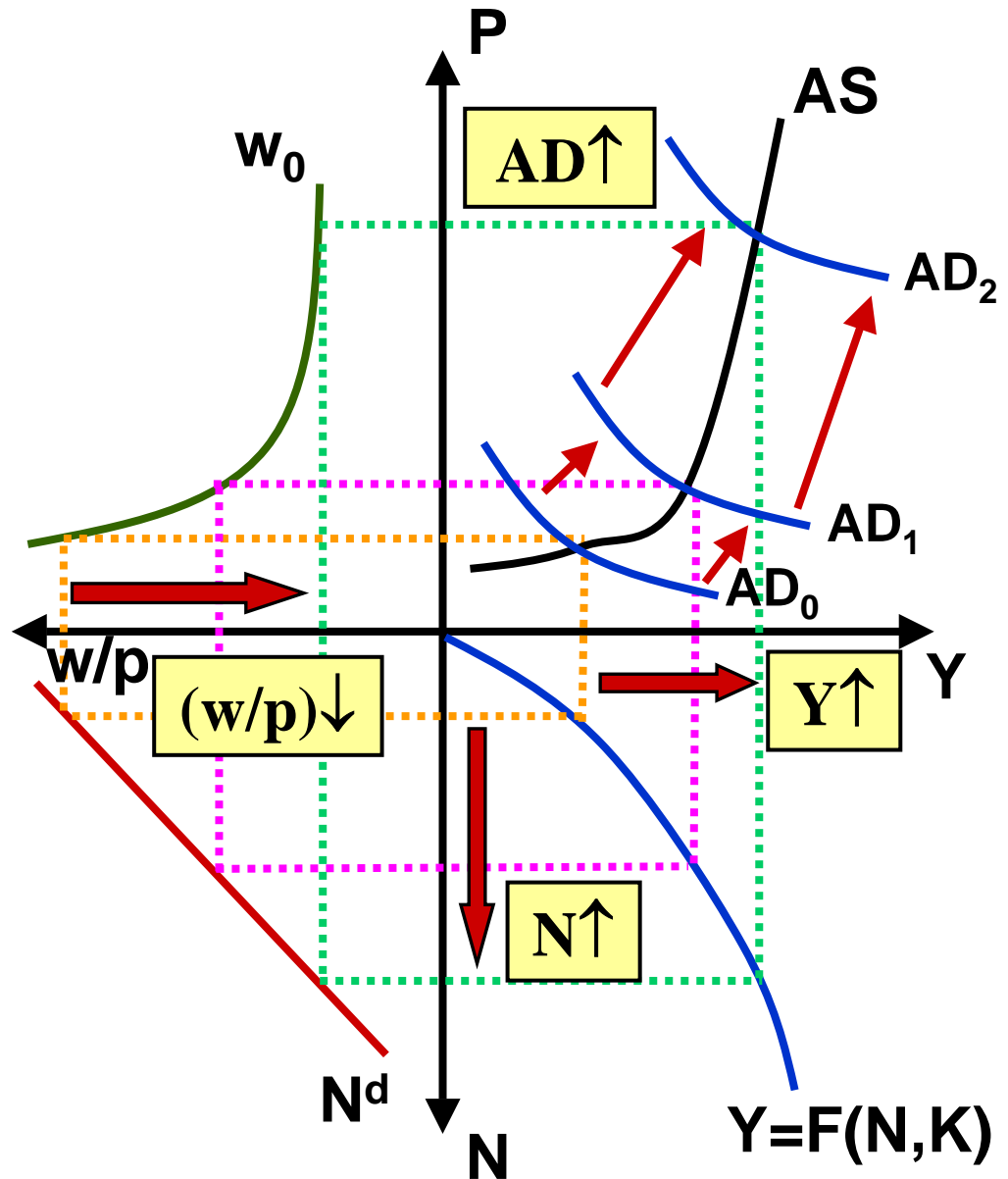
**Recall that:**

$$Y = C + I + G + NX.$$

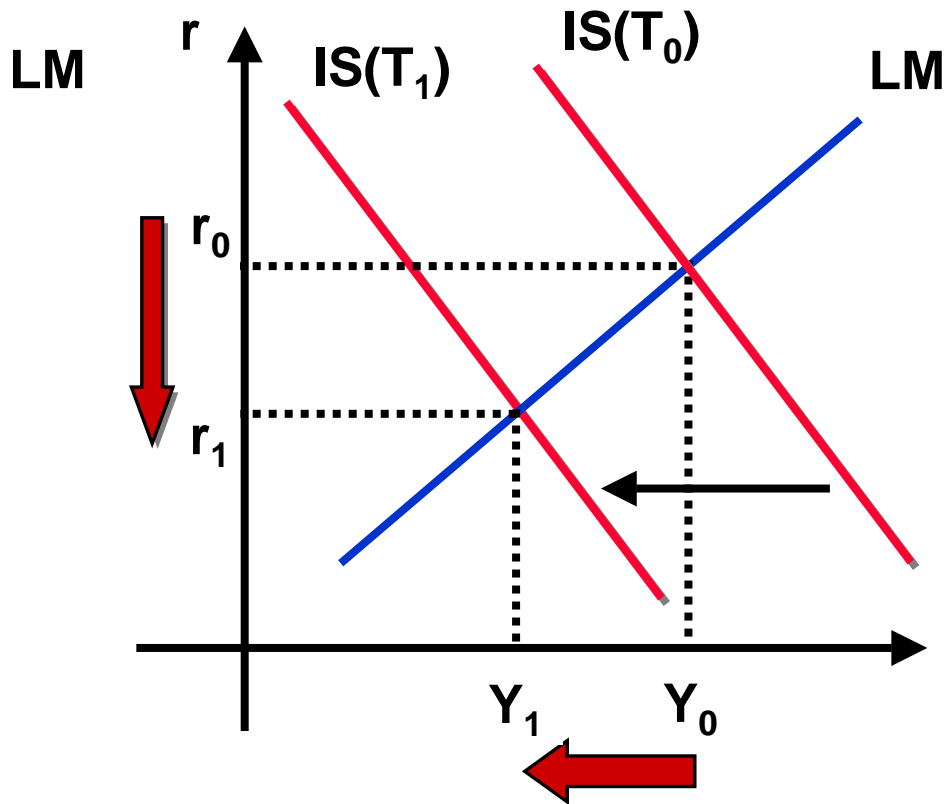
**When  $G \downarrow$  then  $Y \downarrow$ .**

**NOTES:**

1. **G rises, increasing AD.**
2. **Employment and output result from AD increases.**
3. **Prices (P) also rise.**
4. **As prices rise, the real wages fall, making labor more attractive.**
5. **As more workers are employed, and unemployment falls.**



# Increase in Taxes

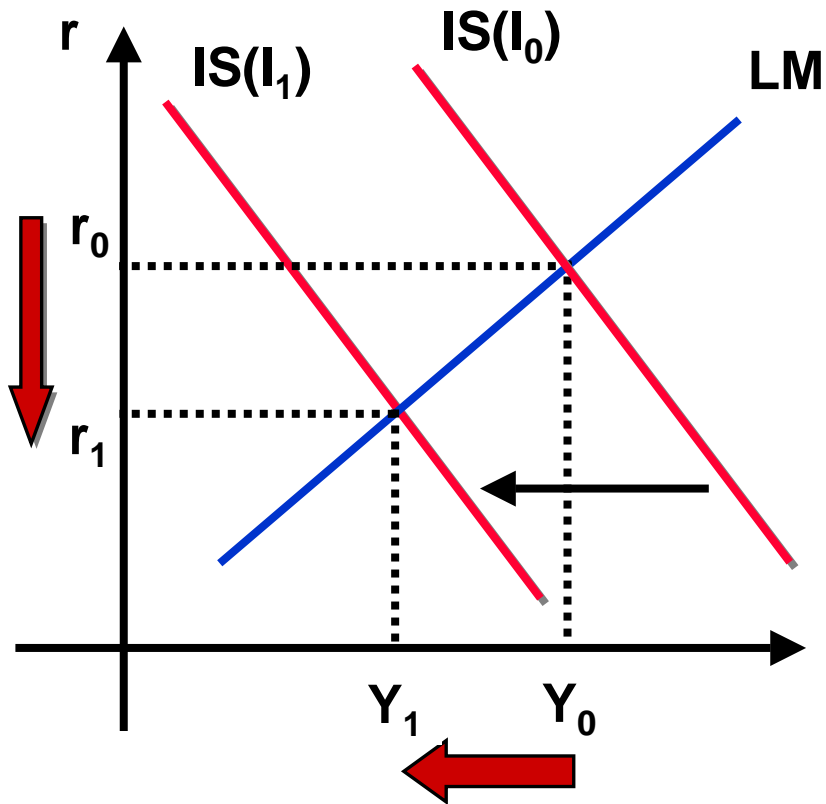


**Recall that:**

$$Y = C + I + G + NX.$$

**When  $T \uparrow$  then  $Y_d \downarrow$ ,  
and so must  $C \downarrow$  and  $Y \downarrow$ .**

# Investment Falls



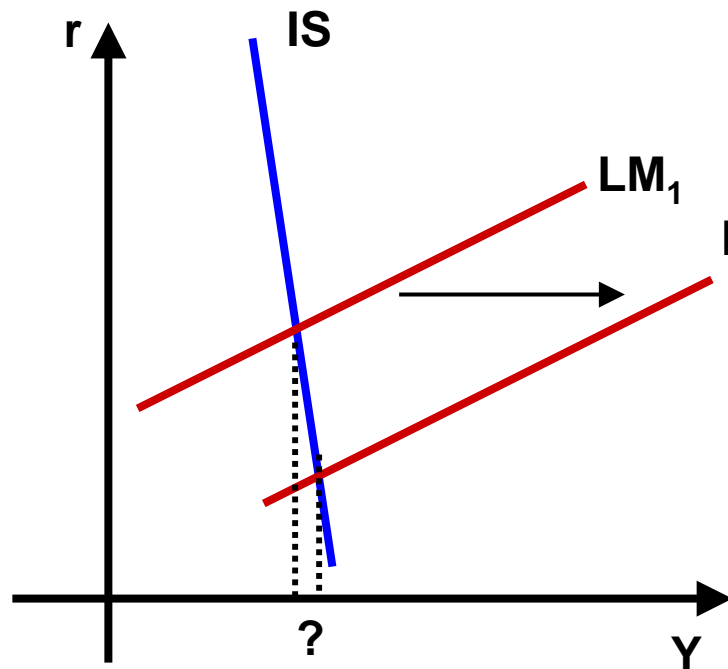
**Recall that:**

$$Y = C + I + G + NX.$$

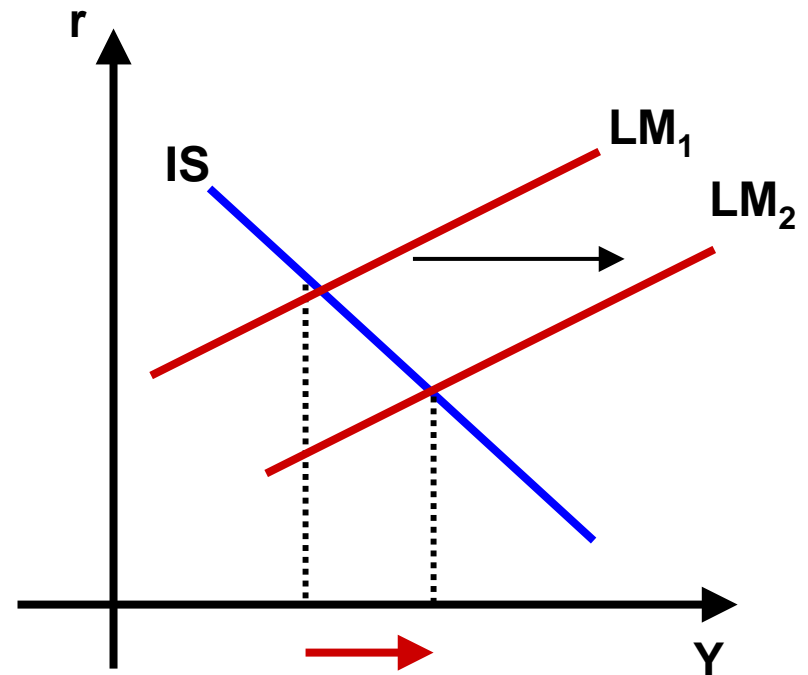
**When  $I \downarrow$  then  $Y \downarrow$ .**



# Monetary Policy Effectiveness

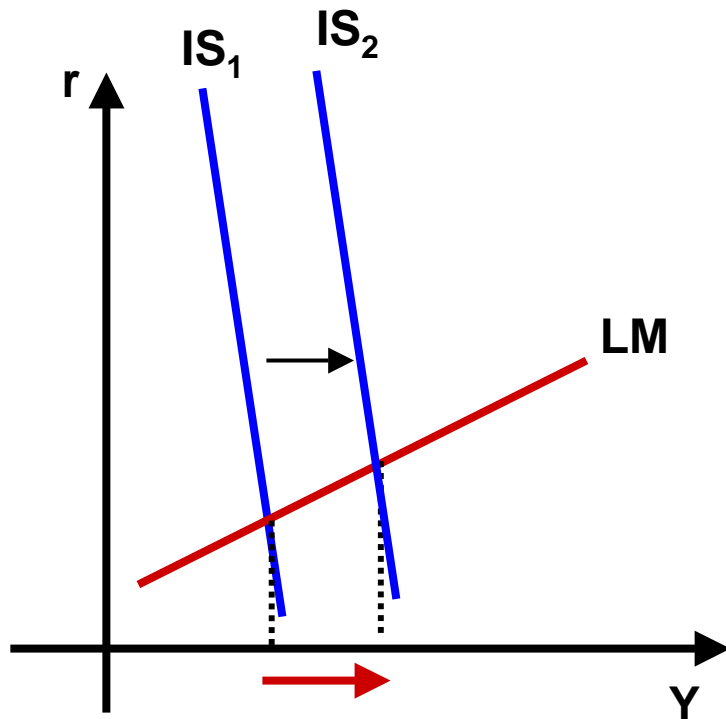


Investment not responsive to interest rate changes

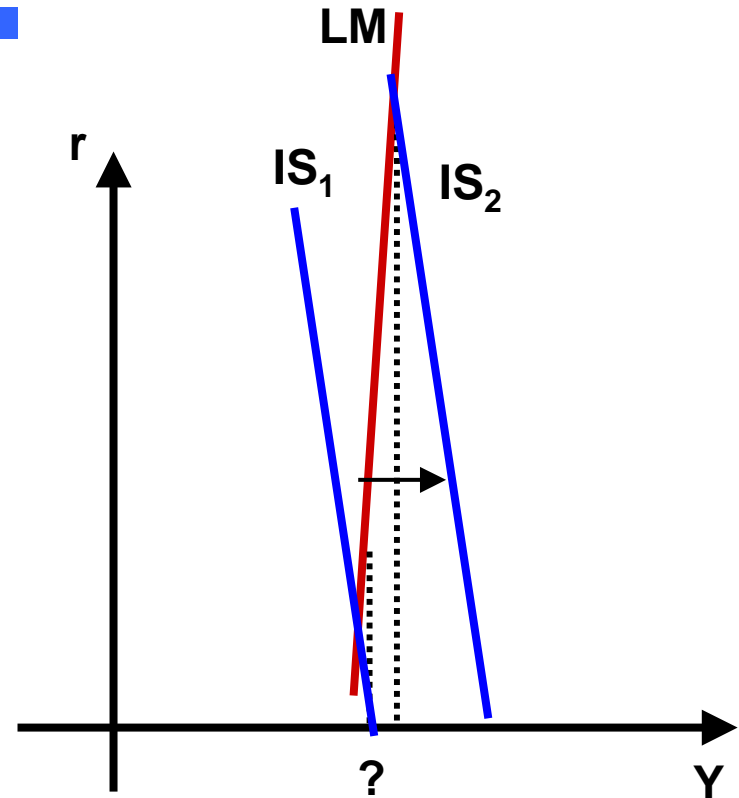


Investment is responsive to interest rate changes

# Fiscal Policy Effectiveness



Money demand is responsive to interest rate changes



Money demand not responsive to interest rate changes

# Keynesian Theory of Inflation

