

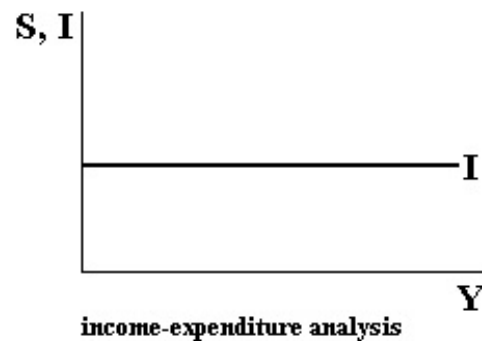
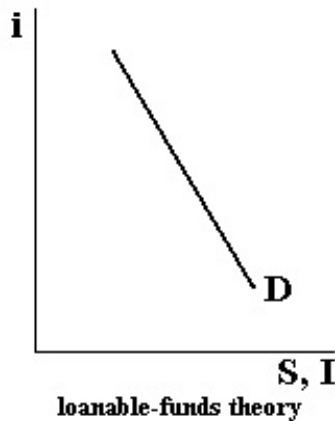
## Study Problem: Keynes and the Classics on Saving and Investment

### Loanable Funds Theory vs. Income Expenditure Analysis

The two sets of axes provided are labeled in accordance with the loanable-funds theory and simple Keynesian income-expenditure analysis. Investment in the loanable-funds market is represented by the demand for loans; investment in the income-expenditure framework is depicted as being independent of the current level of income.

Assume that government spending and the level of taxation are both zero. Suppose that—contrary to Keynes’s assumption that saving preferences do not change—people do become more thrifty. The change in their saving behavior may be driven by, say, a perceived need to pay for their children’s education or to provide for their own retirement years.

Draw in the relevant saving relationship in each of the analytical frameworks. Then, show the effects of a change in saving preferences and summarize your results by responding to questions 1 through 5 (for loanable funds theory) and questions 6 through 10 (for income expenditure analysis).



1. The equilibrium level of saving  
A. increases. B. decreases. C. remains unchanged.
2. The equilibrium level of investment  
A. increases. B. decreases. C. remains unchanged.
3. The equilibrium level of (current) income  
A. increases. B. decreases. C. remains unchanged.
4. The equilibrium rate of interest  
A. increases. B. decreases. C. is irrelevant.
5. The equilibrium level of (current) consumption  
A. increases. B. decreases. C. remains unchanged.
6. The equilibrium level of saving  
A. increases. B. decreases. C. remains unchanged.
7. The equilibrium level of investment  
A. increases. B. decreases. C. remains unchanged.
8. The equilibrium level of income  
A. increases. B. decreases. C. remains unchanged.
9. The equilibrium rate of interest  
A. increases. B. decreases. C. is irrelevant.
10. The equilibrium level of consumption  
A. increases. B. decreases. C. remains unchanged.