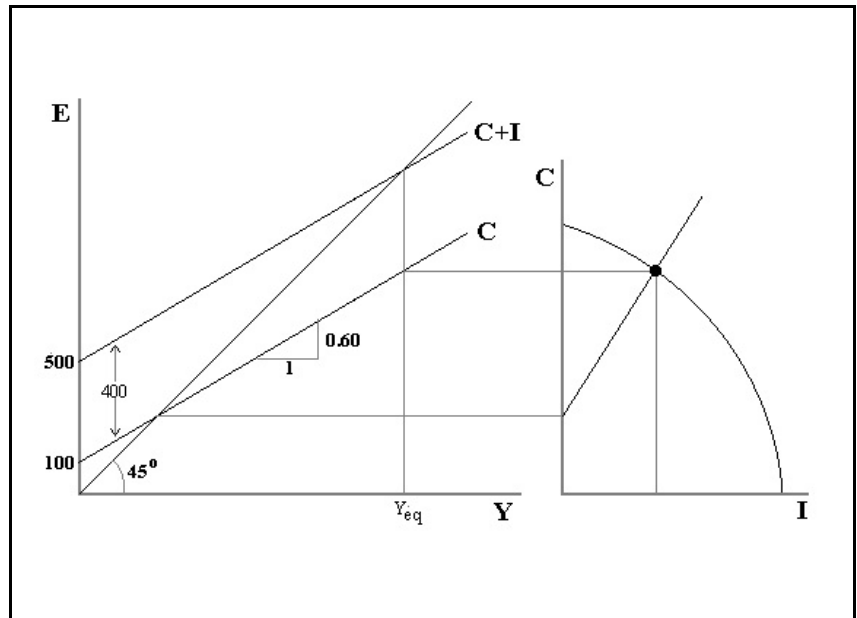


Study Problem: Linking the Keynesian Cross with the Production Possibilities Frontier

The wholly private economy of Maynardia is illustrated in the accompanying diagram, which links the Keynesian Cross and the PPF. We see that $I = 400$, and we assume that $G = T = 0$. The economy is currently in equilibrium in both the Keynesian and Classical senses. Answer the questions below, showing your work where possible.



The Maynardian Macroeconomy

- The income level marked Y_{eq} represents an income-expenditure equilibrium. Just how, in the accompanying diagram, is the idea that Y_{eq} is also Y_{fe} conveyed?
- How would an Orthodox Keynesian have conveyed the idea that this particular Y_{eq} happens also to be Y_{fe} ?
- How much would Maynardians spend on consumption if their income were to fall (temporarily) to zero?
A. 100. B. 250. C. 400. D. 500.
- At what level of income would people's consumption spending be exactly equal to their income?
A. 100. B. 400. C. 250. D. 500.
- What is the equilibrium level of income in Maynardia?
A. 250. B. 1000. C. 500. D. 1250.
- What is the equation of the demand constraint (the upward-sloping line in the right-hand diagram), which relates consumption to investment for all possible equilibrium values of income?
A. $C = 100 + 0.6 I$ C. $C = 250 + 0.4 I$
B. $C = 100 + 1.5 I$ D. $C = 250 + 1.5 I$
- With investment spending in Maynardia at 400, the equilibrium level of consumption spending is
A. 850. B. 600. C. 500. D. 250.
- The Keynesian demand constraint, which underlies the last two questions and identifies the possible combinations of consumption and investment that characterize an economy in Keynesian equilibrium,
A. allows the economy to move along the production possibilities frontier in response to an increase in saving.
B. is likely to shift one way or the other in unpredictable ways.
C. makes use of the production possibilities frontier only as a dividing line between recession and inflation.
D. underlies the view that, in the long run, a policy of *laissez faire* will result in full employment.