Chapter 6: Aggregate Expenditures

6.5 Changes in Autonomous Expenditures

- Recall that a change in income (Y) leads to a movement along the AE curve, while a change in autonomous expenditures (spending) will shift the AE curve altogether, thus leading to a new equilibrium level of income.
- The same factors that can change aggregate demand (Chapter 5) can change autonomous expenditures.

A Change in Autonomous Consumption

- (1) **Wealth effect**: the effect of a change in wealth on consumption spending (the two have a direct relationship).
  - A rise in wealth can lead to increased consumption even if actual income remains unchanged.
  - If the stock market is doing well, wealth on paper increases, prompting consumers to buy more (even though the benefits of the stock market increase may not have been actually deposited into their bank accounts).
- (2) A change in the price level also leads to a change in consumption since it affects our real wealth (i.e. our purchasing power).
  - If wealth increases at the same time as the price level increases, then real income remains unchanged; however, the value of our assets has declined, reducing our purchasing power and making us more cautious about consumption.
  - **Real-balances effect**: the effect that a change in the value of real balances has on consumption spending (the value of real balances is affected by changing price levels).
- (3) As the stock of consumer durables gets older, the likelihood of increased consumption spending grows as the need for replacement increases.
  - Households replace goods because they grow tired of them and can afford to purchase newer models or alternatives (this scenario is dependant on income).
  - Households also replace goods because they wear out and must be replaced regardless (or at least within reason) of the current state of the householder’s income flow.
- (4) Changes in consumers’ expectations about the future of the economy (relating to job availability, salary and wage trends, and expected changes in future prices) can encourage or discourage current spending,
  - If consumers become more optimistic, autonomous consumption spending increases.
  - If consumers become more pessimistic, autonomous consumption spending decreases.

A Change in Investment

- Recall that in the AE model investment is fully autonomous of income.
- (1) Since much investment spending is financed with borrowed money, the interest rate at which money can be borrowed plays a big role in determining whether an organization should pursue or hold off on investment spending in the present.
  - Even if the investment is self-financed by a company, the rate of return is an important consideration because the firm could choose to keep the money in a savings certificate instead, thus earning a guaranteed return on it, as opposed to spending it on investment (which you’ll recall refers to spending on capital goods).
  - A change in investment spending is mainly determined by the real rate of interest, not the nominal rate of interest.
- (2) The purchase price, installation, maintenance, and operating costs of capital goods impact whether that purchase is a profitable one, thus impacting whether the investment occurs.
(3) As the age of an economy’s capital stock increases, the goods must be replaced with the purchase of new capital goods, thus increasing investment.

(4) Business expectations affect investment spending, since investment spending will rise as businesses become more optimistic about the future and decline when they grow pessimistic.

(5) Government regulations can impact costs; if new regulations are imposed, investment spending may be cut simply because it becomes too costly, whereas cutting some of the “red tape” might make it easier and more profitable for businesses to increase their investment spending.

A Change in Government Spending

- Although the AE model views government spending as wholly autonomous, it can change as government policy changes.
  - Interest rates, social and cultural standards, voters’ expectations, budget philosophies, and political considerations can impact government spending.
- In the short run, the level of government spending is not dependent on levels of taxes and other revenues, since governments can and often do spend in excess of revenue.

A Change in Autonomous Net Exports

- Recall that exports are wholly autonomous while imports are partially autonomous and partially induced by income.
- (1) Net exports will be affected by the level of prices in the country compared with prices in other countries (since they will either be more or less expensive for foreign consumers/markets to purchase).
- (2) The value of a country’s currency will also make that country’s good more or less expensive (and thus more or less appealing) to consumers in foreign markets.
- (3) A change in the level of income in the countries that import our goods (i.e., to whom we export) will also change our autonomous net exports, since an increase in the income levels of foreign economies will increase foreign demand for our goods and services, while a decrease in their income levels would decrease their demand for our products.