

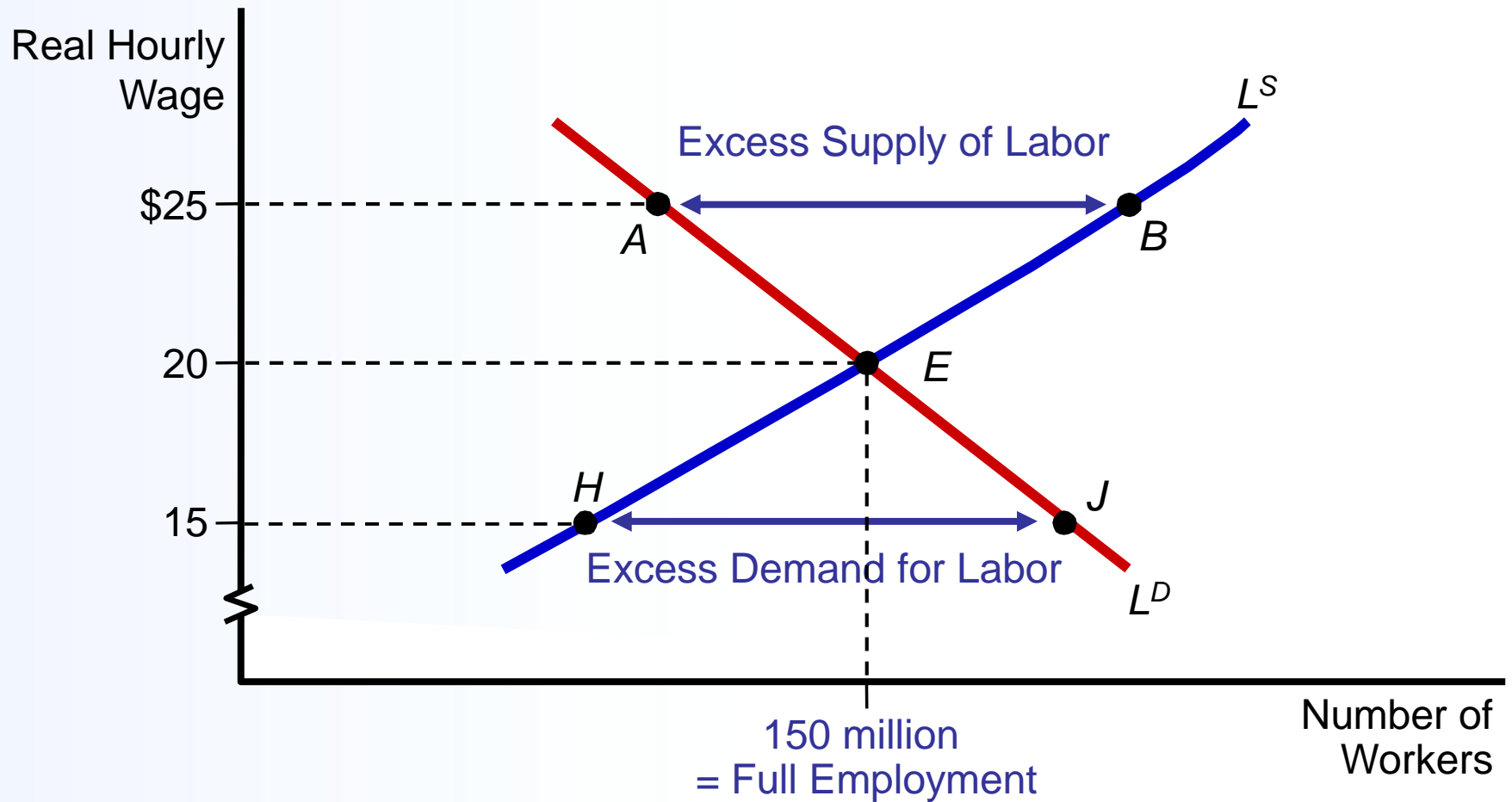
Chapter 7



The Classical Long-Run Model

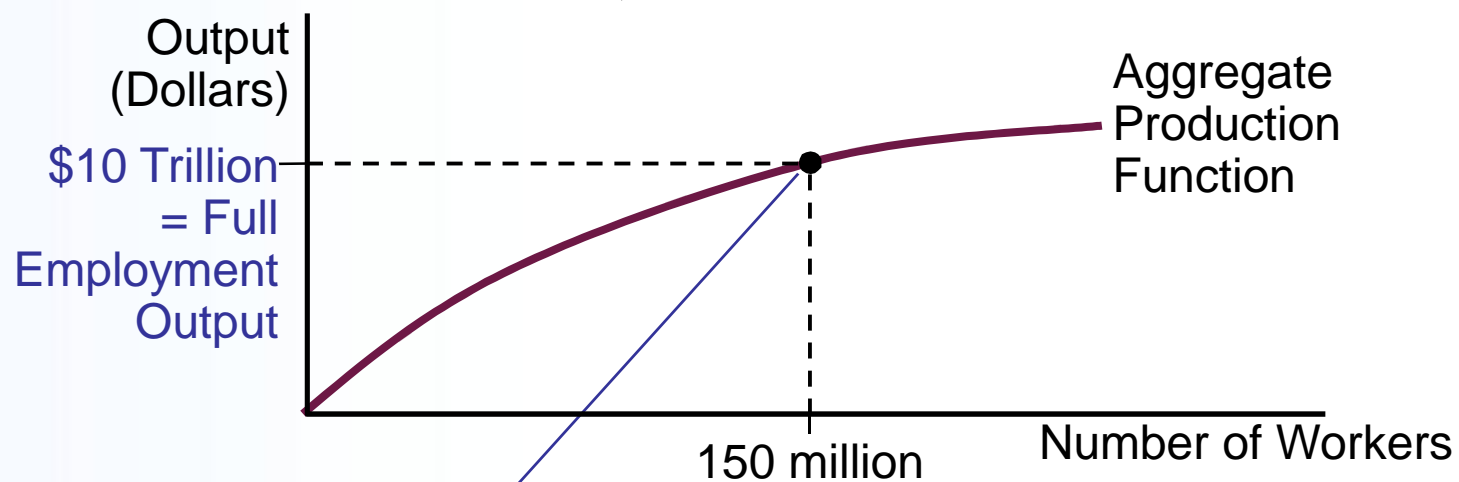
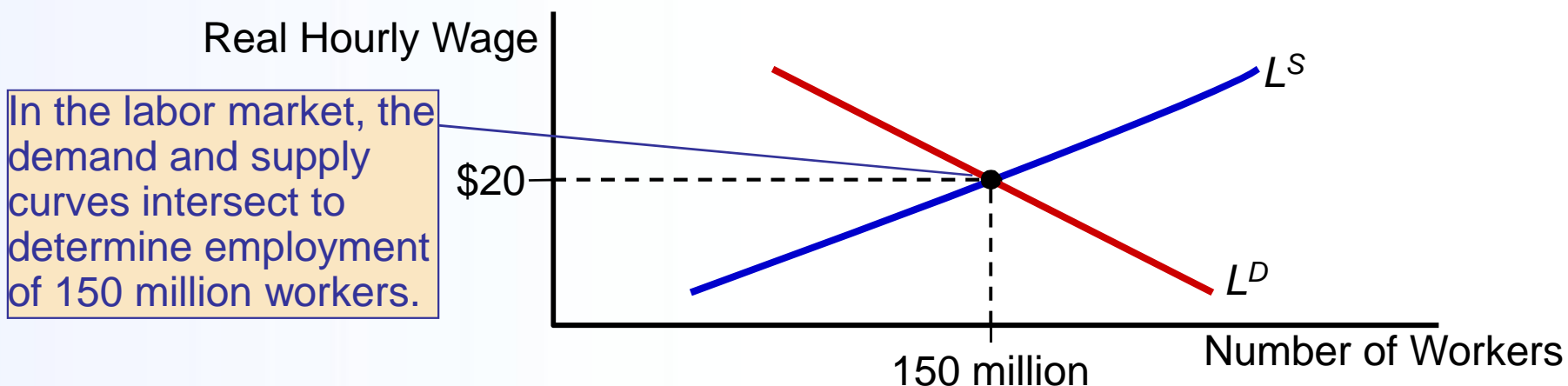
The Labor Market

• **Figure 1** The Labor Market



The Production Function

- **Figure 2** Output Determination in the Classical Model



The production function shows that those 150 million workers can produce \$10 trillion of real GDP.

Total Spending in a Simple Economy

- **Figure 3** Total Spending in a Simple Economy

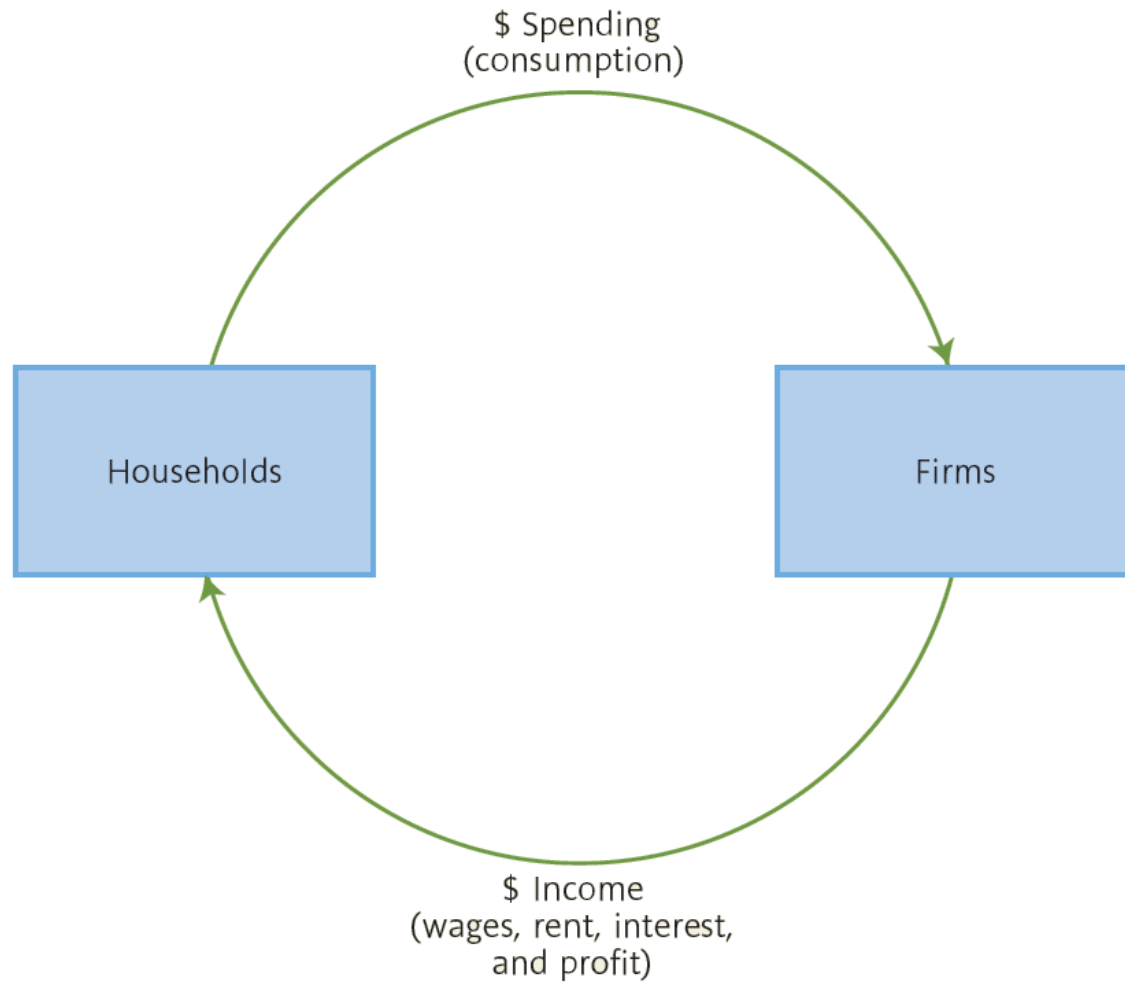
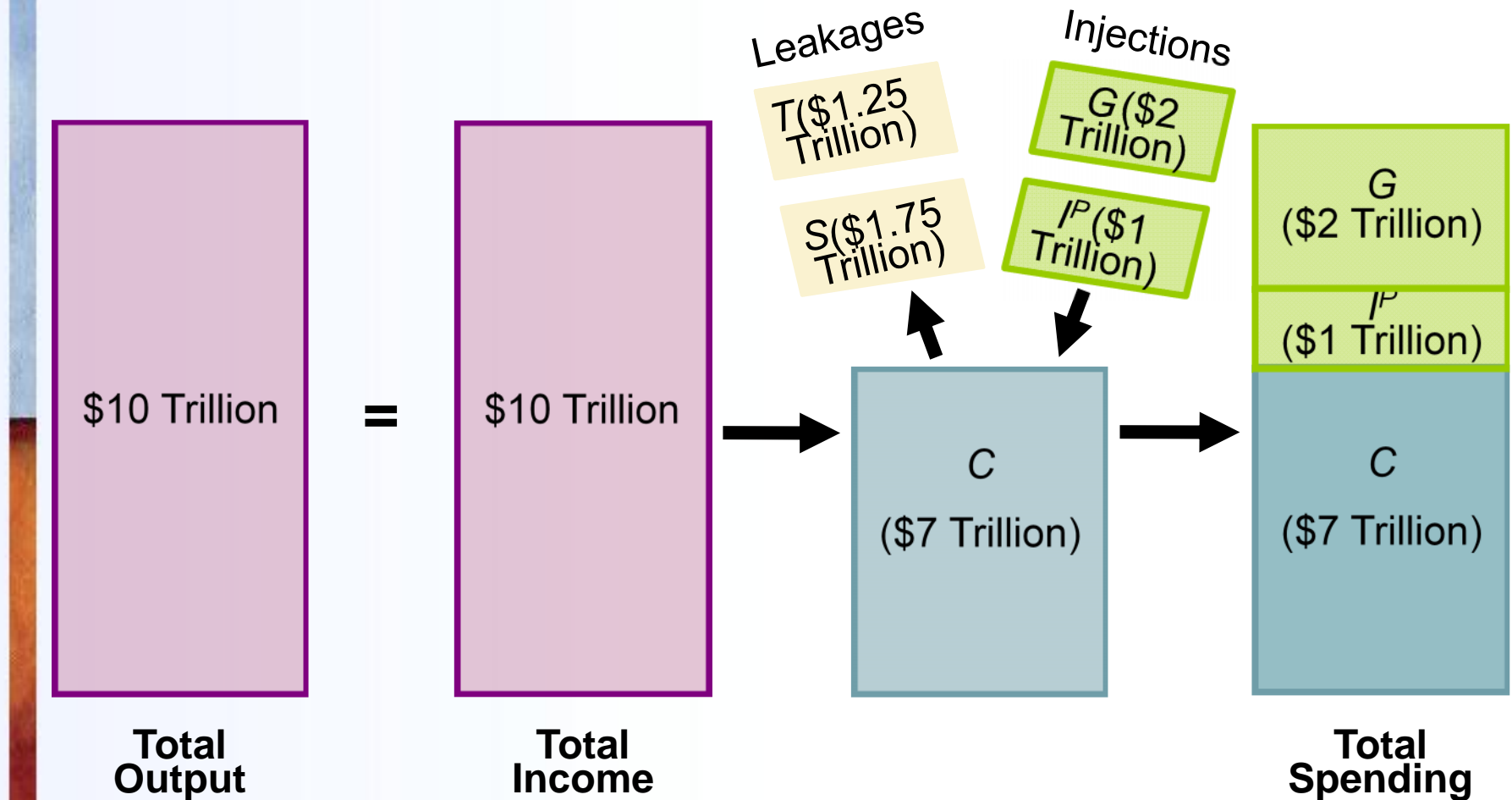


Table 1: Flows in the Economy of Classica, 2006

Total Output (GDP)	\$10 trillion
Total Income	\$10 trillion
Consumption Spending (C)	\$7 trillion
Planned Investment Spending (I^p)	\$1 trillion
Government Purchases (G)	\$2 trillion
Net Taxes (T)	\$1.25 trillion
Household Saving (S)	\$1.75 trillion

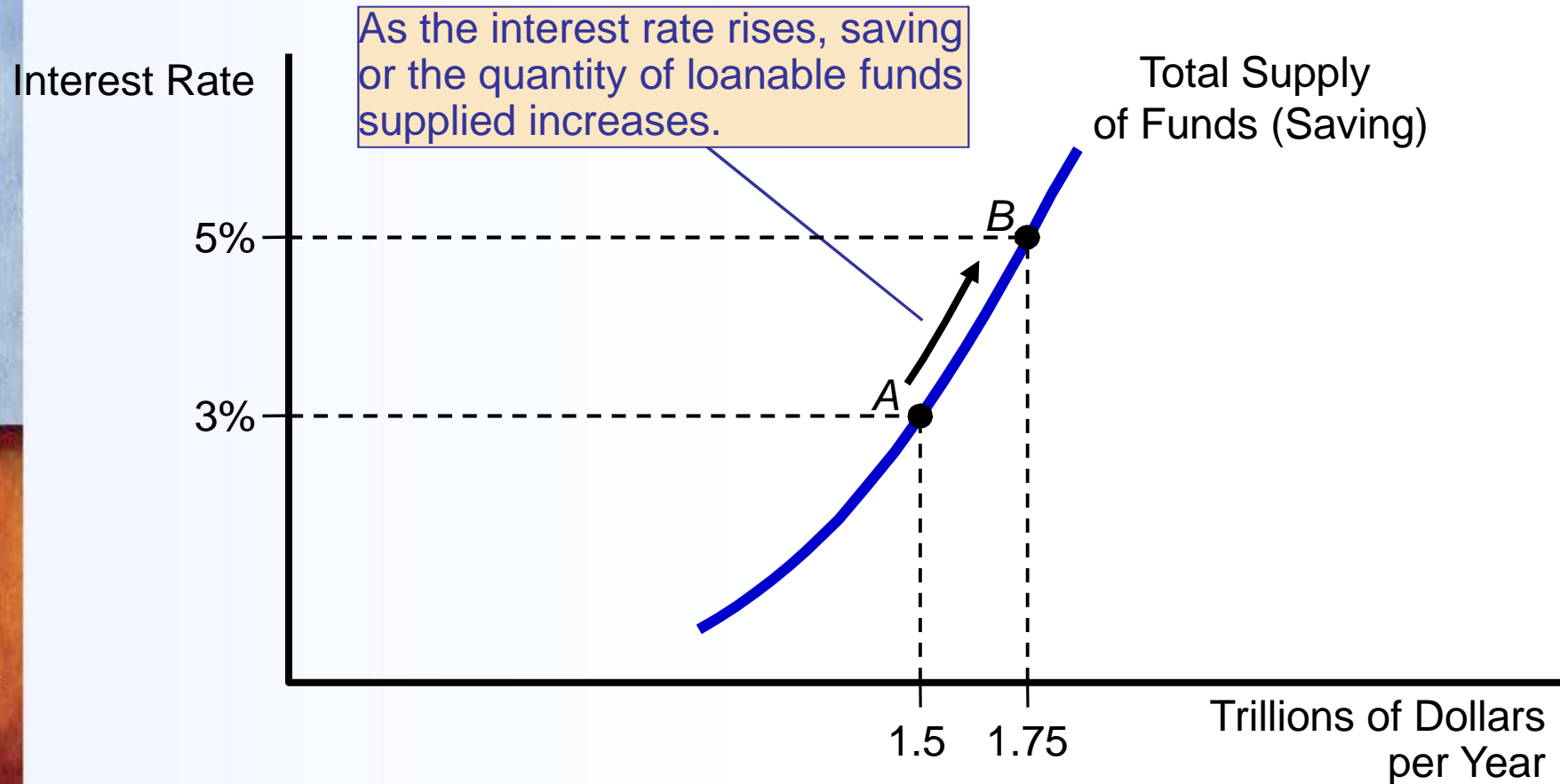
Leakages and Injections

- **Figure 4** Leakages and Injections



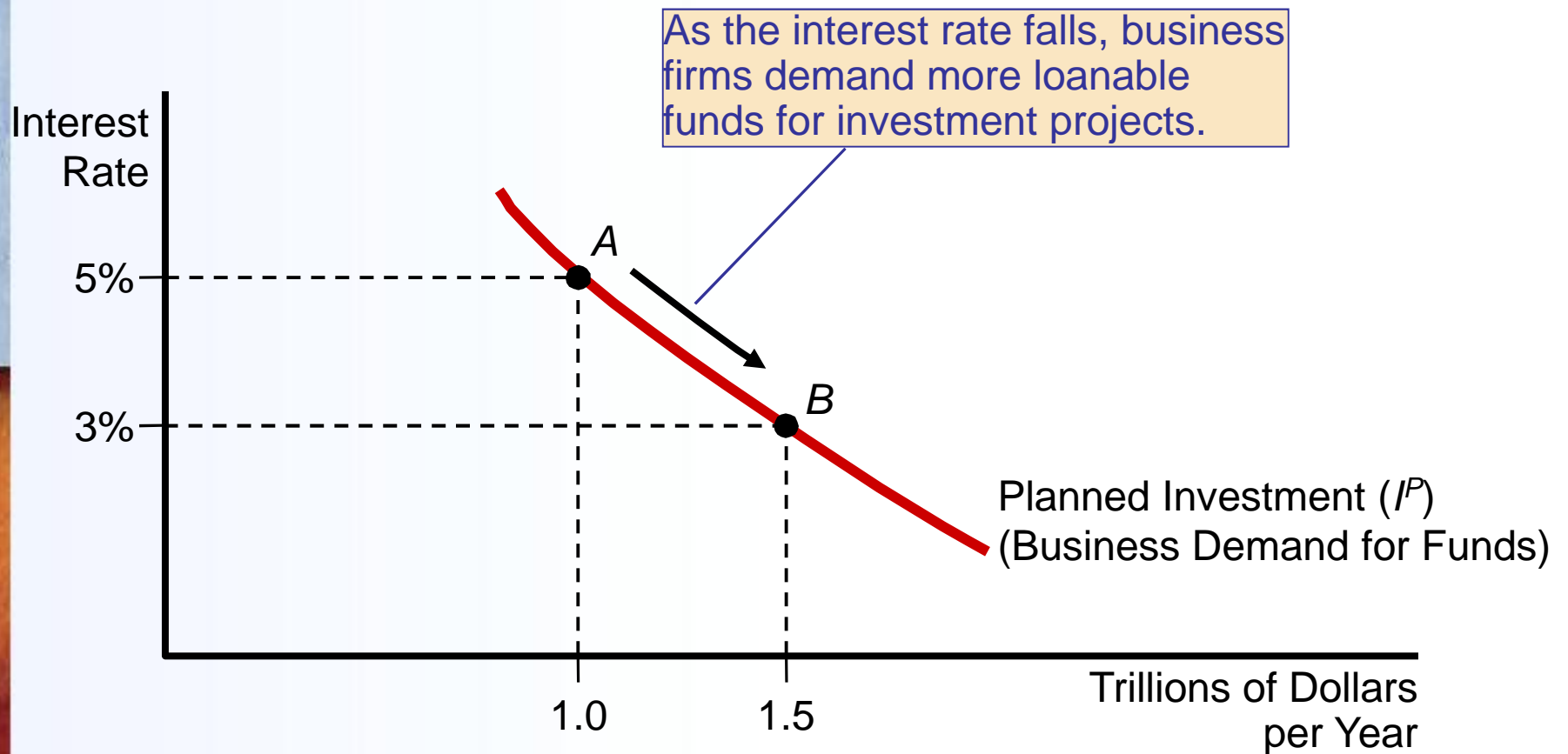
The Supply of Funds Curve

- **Figure 5** Household Supply of Loanable Funds



Business Demand for Loanable Funds

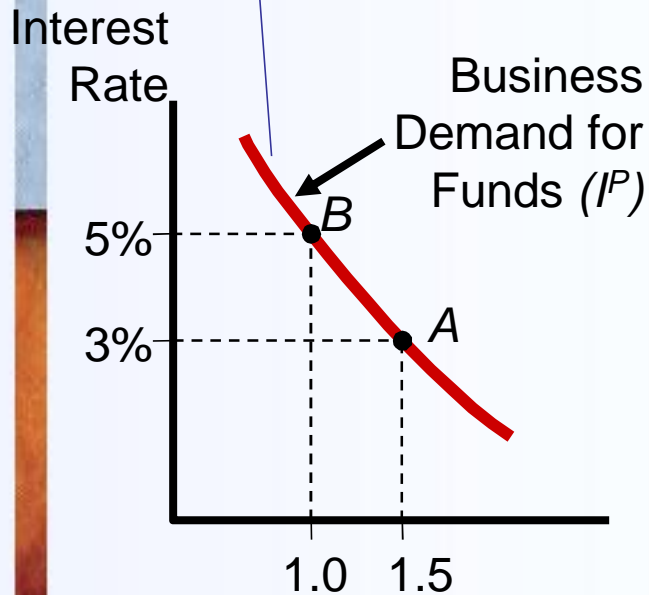
- **Figure 6** Business Demand for Loanable Funds



The Demand for Funds

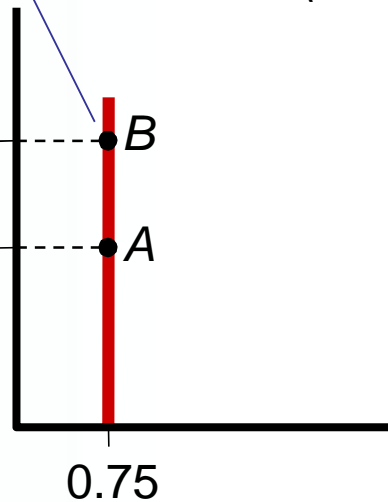
- Figure 7 The Demand for Funds

Summing business demand for loanable funds at each interest rate . . .



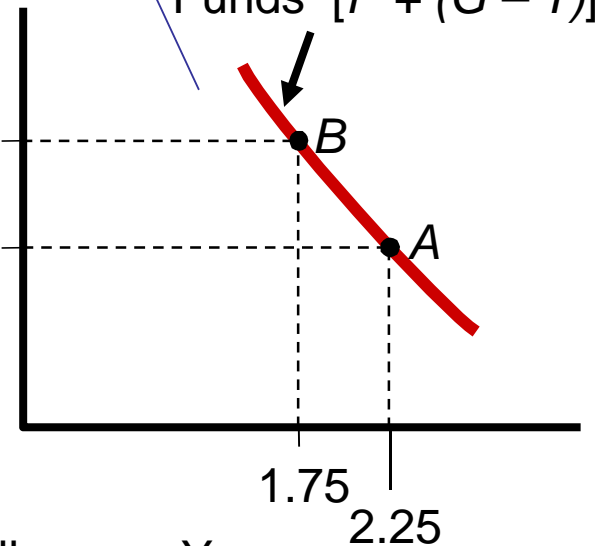
and the government's demand for loanable funds

Government Demand for Funds ($G - T$)



gives us the economy's total demand for loanable funds at each interest rate.

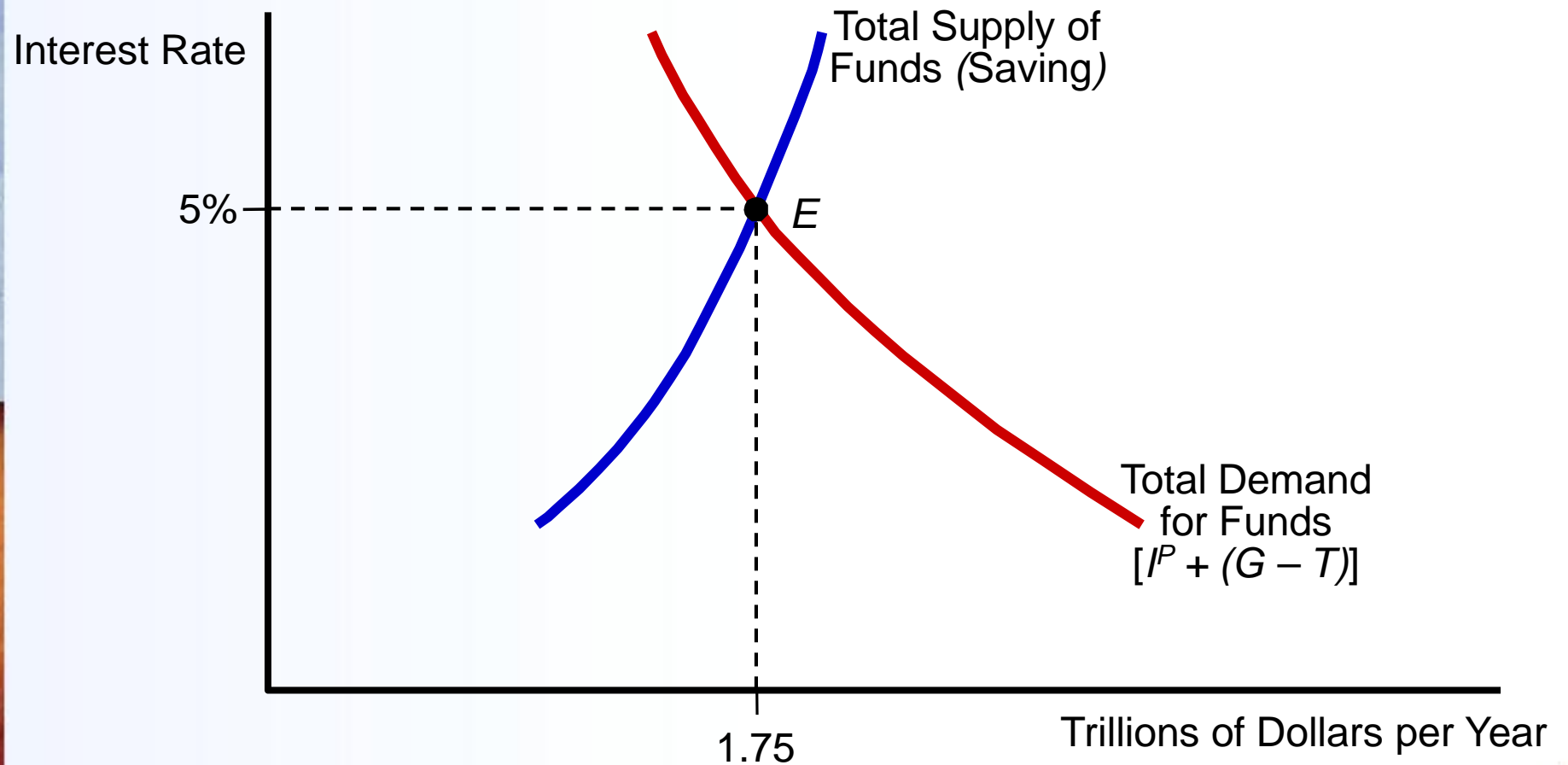
Total Demand for Funds [$I^P + (G - T)$]



Trillions of Dollars per Year

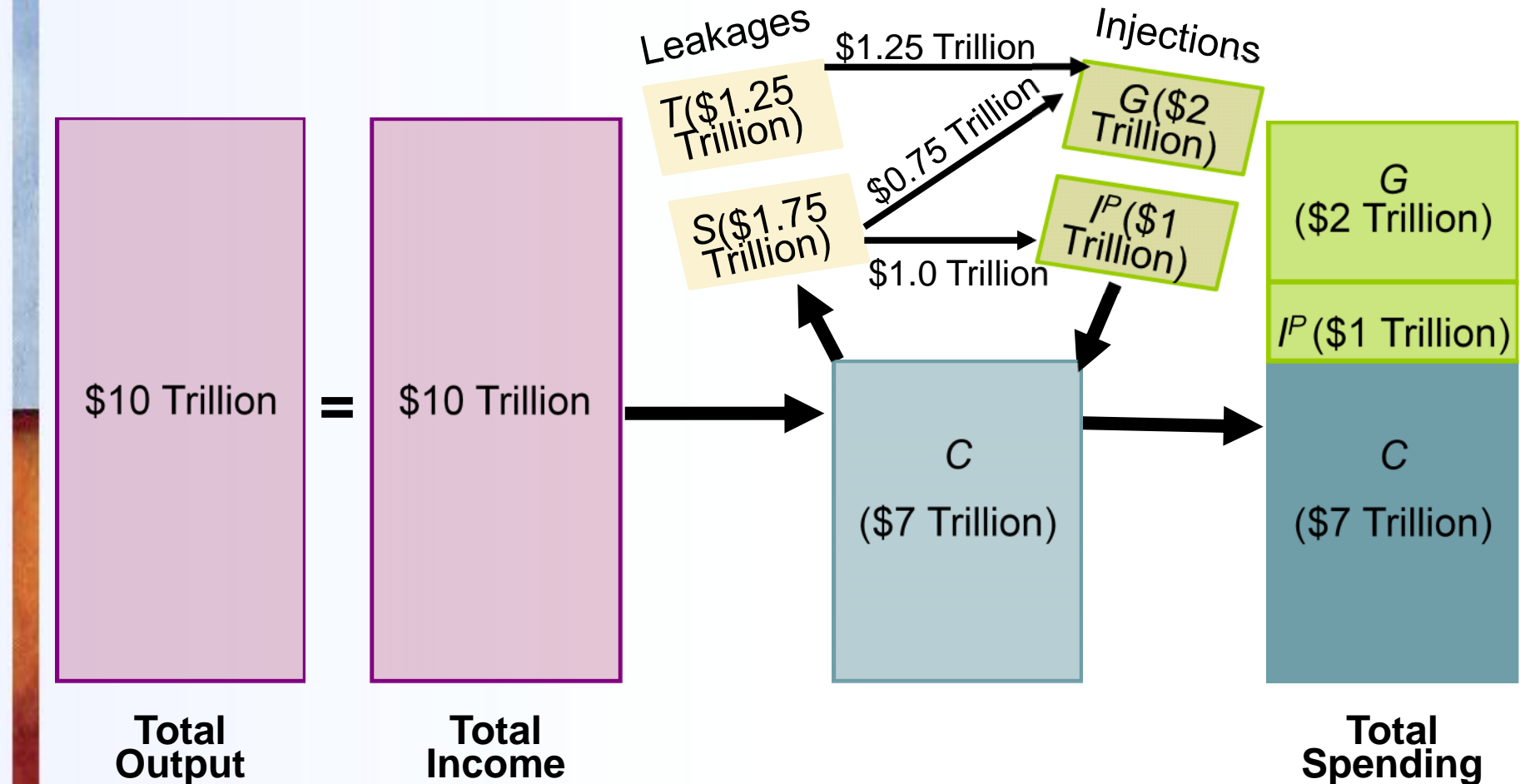
Equilibrium in the Loanable Funds Market

- **Figure 8** Loanable Funds Market Equilibrium



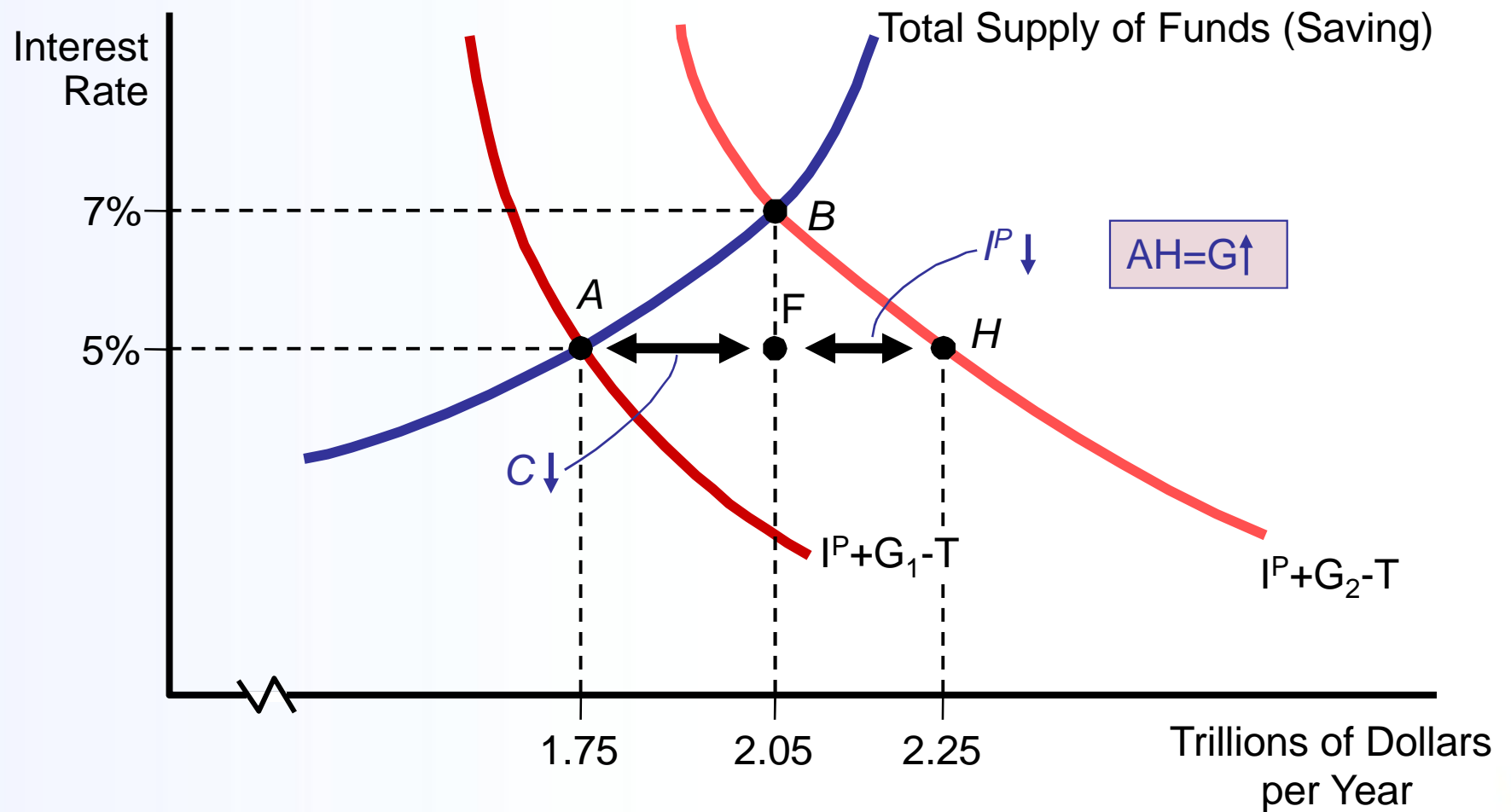
The Loanable Funds Market and Say's Law

- Figure 9 Loanable Funds Market: Total Spending = Total Output



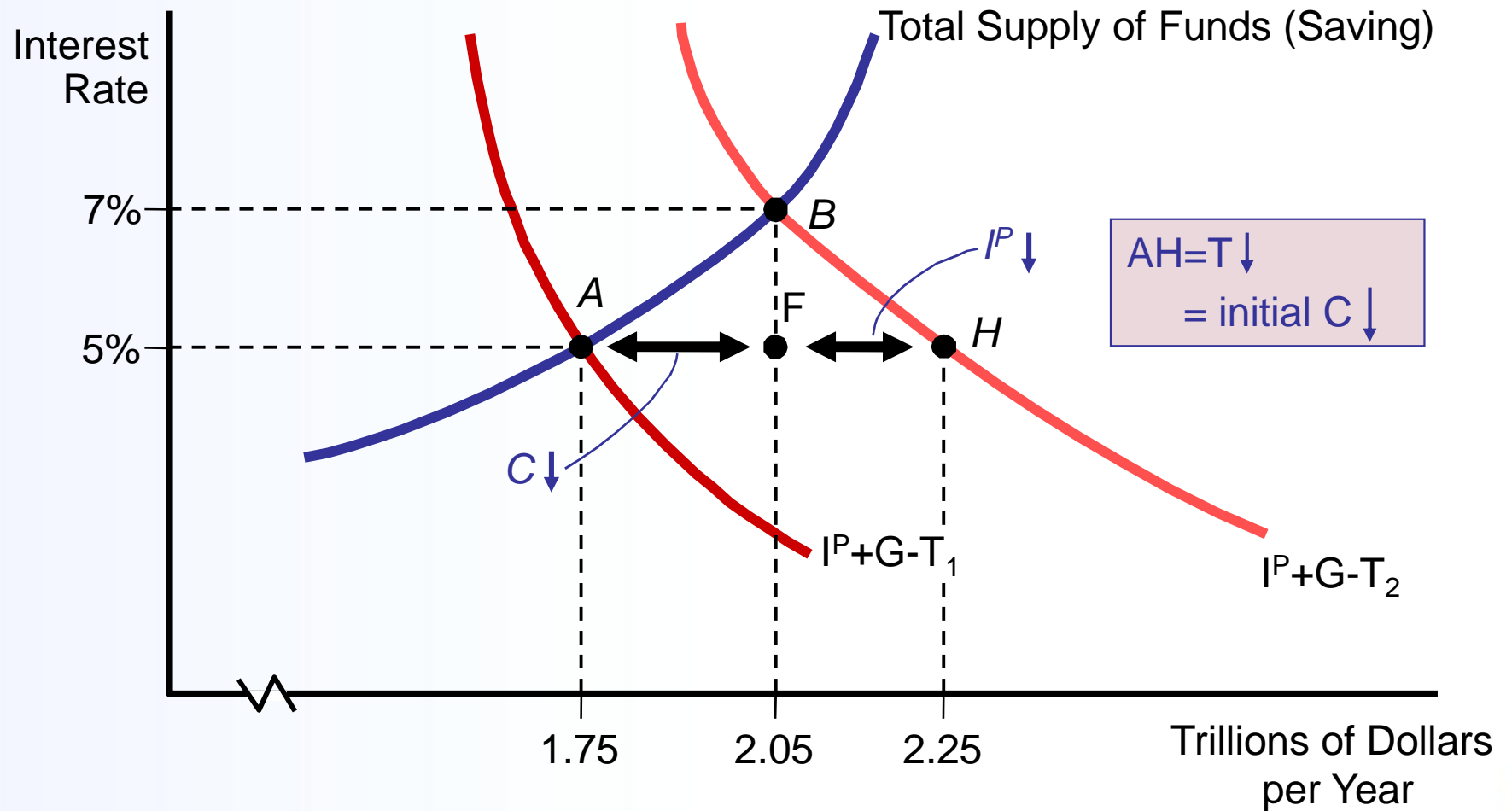
An Increase in Government Purchases

- **Figure 10** Crowding out from an increase in Government purchases



A Decrease in Net Taxes

- Figure 11 Crowding out from a tax cut



Appendix: The Classical Model - Open Economy

- **Figure A.1** The Loanable Funds Market with a Trade Deficit

