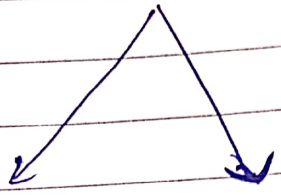
## Aggregate Demand in a Two Sector model

→ The two sector model consists of two sectors - Households and firms) for determination of income and employment.

→ Thus, the third and fourth components of aggregate demand are not included.

→ The two expenditures included in the two sector model



Investment Expenditure

Consumption expenditure.

**Thus, AD = C + I**

AD = Consumption expenditure + Investment expenditure.

## DIAGRAMMATIC REPRESENTATION OF AD

→ Diagrammatic representation and Schedule.

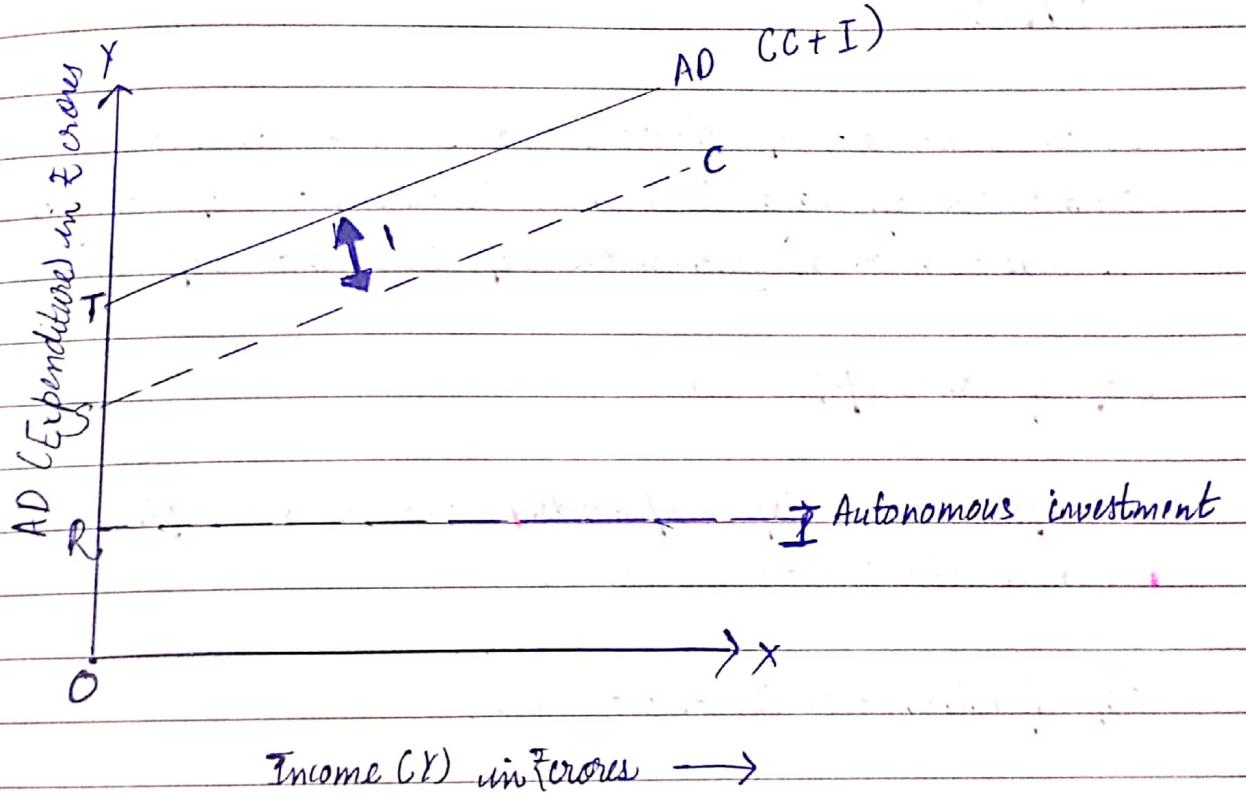
There exists a positive relationship between income and aggregate expenditure in the economy i.e. as level of income rises AD rises.

Aggregate expenditure $\propto$ Income in the country

$\propto$ - symbol of direct proportion.

| Income (Y) | Consumption (C) | Investment (I) | AD C + I |
|---|---|---|---|
| 0 | 40 | 20 | 60 |
| 100 | 120 | 20 | 140 |
| 200 | 200 | 20 | 240 |
| 300 | 280 | 20 | 300 |
| 400 | 360 | 20 | 380 |
| 500 | 440 | 20 | 460 |
| 600 | 520 | 20 | 540 |

Aggregate Demand schedule (in ₹crores)




## Important points about AD in Two Sector model

1. $AD = C + I$

⇒ Aggregate demand is the sum of consumption demand and investment demand.

(2) There is always some minimum level of consumption, even the income is zero. It happens because people needs certain basic goods and services required by people for survival even with zero income.

(3) AD curve is parallel to Consumption curve: The difference/ the area between the AD curve and consumption curve is Investment expenditure.

$AD = C + I$

$\therefore AD - C = I$

Since investment expenditure remains constant i.e. autonomous of change in income. Investment expenditure is thus termed as autonomous investment expenditure.

(4) Slope of Consumption curve:

→ Consumption curve slopes upwards because consumption increases with increase in income.

(5) Slope of Autonomous investment curve:

→ It is parallel to x axis as it is assumed to be independent of the level of income.

⇒ Slope = zero.

(6) Slope of AD curve:

→ It also has a positive slope as it indicates that as income

increases, aggregate expenditure also increases.