Types of expenditure [components of AD]

- (Consumption expenditure) [C]
- Government expenditure [G]
- Investment expenditure [I]
- Net exports [X - M]

$$\boxed{AD = C + G + I + X - M}$$

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Consumption expenditure (C):

- Consumption expenditure refers to the expenditure incurred on purchase of goods and services during an accounting year by households.

- Consumption expenditure is directly proportional to disposable income i.e. higher is the consumption expenditure if disposable income is high.

Disposable income refers to the income received by a household from all sources used for consumption expenditure and savings.

Government expenditure

Government expenditure refers to the expenditure incurred (total) by the government on consumer goods and capital goods to satisfy the needs of the economy.

~~Consumer goods refer~~

Expenditure for consumption includes health, education, law and order.

Expenditure for capital goods includes roads, electricity etc.

Investment expenditure

Investment expenditure refers to the expenditure incurred for capital goods.

These include change in inventory, addition to machinery etc.

Net exports (X-M)

Exports of goods refers to the demand of domestically produced goods ~~in~~ abroad i.e. foreign countries. Imports of goods refers to the demand of internationally produced goods in the domestic market.

Net exports refers to the difference between exports and imports of goods.

AD in Two sector model

Aggregate demand in two sector model comprises of only two sectors i.e. Consumption expenditure and investment expenditure.

$\boxed{AD = C + I}$ in two sector model