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Is lm model equilibrium

The IS-LM model, which stands for investment-savings (IS) and liquidity preference-money supply (LM) is a Keynesian macroeconomic model that shows how the market for economic goods (IS) interacts with the market for loans (LM) or money market. It is shown as a graph in which the IS and LM curves intersect to show the short-term balance between interest rates and production. The IS-LM model describes how aggregate markets for real goods and financial markets work together to balance interest rates and overall output in the macro-economy. IS-LM stands for investment savings-liquidity preference-money supply. The model was conceived as a formal graphic representation of a principle of Keynesian economic theory. On the IS-LM chart, IS represents a curve, while LM represents a different curve. IS-LM can be used to describe how changes in market preferences change the equilibrium level of gross domestic product (GDP) and market interest rates. The IS-LM model lacks the precision and realism to be a useful prescription tool for economic policy. British economist John Hicks first introduced the IS-LM model in 1936, just a few months after fellow British economist John Maynard Keynes published The General Theory of Employment, Interest, and Money. Hicks' model served as a formalized graphic representation of Keynes's theories, although it is mainly used as a heuristic device today. The three critical exogenous, i.e. external, variables in the IS-LM model are liquidity, investment and consumption. According to the theory, liquidity is determined by the size and speed of the money supply. Investment and consumption levels are determined by the marginal decisions of individual actors. The IS-LM chart examines the relationship between production, or gross domestic product (GDP), and interest rates. The whole economy is down to just two markets, manufacturing and money; and their respective supply and demand characteristics push the economy to a equilibrium point. The IS-LM graph consists of two curves, IS and LM. Gross domestic product (GDP), or (Y), is placed on the horizontal axis, which increases to the right. The interest rate, or (i or R), forms the vertical axis. The IS curve shows the range of all levels of interest and production (GDP) where total investment (I) equals total savings (S). At lower interest rates, investment is higher, which translates into more total output (GDP), causing the IS curve to descend downwards and to the right. The LM curve shows the set of all income levels (GDP) and interest rates at which money supply equals the demand for money (liquidity). The LM curve is increasing as higher income levels (GDP) lead to demand to hold cash balances for transactions, which requires higher interest rates to balance demand for money and liquidity. The crossroads of the IS and LM LM shows the equilibrium point of interest rates and production when money markets and the real economy are in balance. Multiple scenarios or times can be displayed by adding additional IS and LM curves. In some versions of the chart, curves show limited convexity or concavity. Shifts in the position and shape of the IS and LM curves, which represent changing preferences for liquidity, investment and consumption, change the level of balance of income and interest rates. Many economists, including many Keynesians, object to the IS-LM model because of its simplistic and unrealistic assumptions about the macro-economy. In fact, Hicks later admitted that the model flaws were fatal, and it was probably best used as a classroom gadget, to be replaced, later, by something better. Subsequent revisions have been made for so-called new or optimized IS-LM frameworks. The model is a limited policy instrument because it cannot explain how tax or spending policies should be formulated with any specificity. This significantly limits its functional appeal. It has very little to say about inflation, rational expectations, or international markets, although later models try to incorporate these ideas. The model also ignores the formation of capital and labour productivity. This post deals with a number of common economic problems associated with the IS-LM model. Remember that the IS-LM model shows the relationship between real income (Y) and real interest rates (i) using the IS (Investment and Saving balance) curve along with the LM (Liquidity Preference and Money supply balance) curve. Four common policies the government can implement are:1. Expansionary fiscal policy (which will shift the IS curve correctly)2. Shrink right policy (which will shift the IS curve to the left)3. Expansionary monetary policy (which will shift the LM curve to the right)4. Shrinking monetary policy (which will shift the LM curve to the left) Depending on the current state of the economy, the government may want to combat high inflation (through shrinkage policy) or help lower unemployment (through expansionary policies). There is trade-off between low inflation and low unemployment, so the government generally has to choose a strategy at a time. Let's start with the basic IS-LM chart, and go through each of the examples above to see what the results will be on balance real earnings and real interest rates. We start with the downward sloping IS curve, and the upward rolling LM curve. We can then add the fiscal policy choices by shifting the IS curve. We can check how the IS curve will shift by revising the IS equation: Y = G (government expenditure – fiscal policy) is exogenous, and that an increase in G- or expansionary fiscal policy will have a positive effect on the comparison or increase the IS curve (shift (shift on the right). Similarly, a decrease in G or shrinkage policies will have a negative effect on the comparison or reduce the IS curve (shift to the left). Looking at the chart, the ISi represents expansive fiscal policy. The new equilibrium point results in higher real GDP or income level Yi>Y and real interest rates ii>i. Please note that the LM curve has not changed. Similarly, the ISd curve represents a shrinking right-rate policy and results in a lower equilibrium in real interest rates and real GDP. When the central bank conducts monetary policy, we will shift the LM curve. We can figure out how the LM curve will shift by looking at the equation: If the central bank adopts expansionary monetary policy, we will see M (the money supply) rise, which has a positive effect on the equation. This causes the LM curve to shift to the right (to LMi), resulting in lower real interest rates and higher real GDP. A decrease in the money supply causes the LM curve to shift to the left (to LMd), resulting in higher interest rates and a lower real GDP balance level. The IS-LM Curve Model (explained with diagram)! The goods market and the money market: Interconnections: In its analysis of national income, the Keynes states that national income is determined at the level at which total demand (i.e. total expenditure) for consumer and investment goods (C+1) is equal to total production. In other words, the simple Keynes model shows that the level of national income is determined by the balance of the goods market. In this simple analysis of the equilibrium of the goods market, Keynes considers investments to be determined by the interest rate and the marginal efficiency of the capital and shows that they are independent of the level of national income. According to Keynes, interest rates are determined by the balance of the money market by the demand for and supply of money. In this Keynes model, changes in interest rates as a result of changes in money supply or change in demand for money will affect the determination of national income and production on the goods market due to changes in the level of investment. In this way, changes in the balance of the money market affect the determination of national income and production on the goods market. However, there is apparently an error in keynesian analysis that has been noted by some economists and is a subject of much of the controversy. It has been claimed that in the Keynesian model, while changes in interest rates on the money market affect investment and therefore at the level of income and production in the goods market, there are seemingly no changes in the goods market, i.e. (investments and revenues) on the balance of the money market. It has been shown by J.R. Hicks and others that with more insights into Keynesian theory it is found that the changes in income caused by changes investments or the tendency to consume on the goods market also affect the determination of interest in the money market. According to him, the level of income that depends on investment and consumption demand determines the demand for money that affects interest rates. Hicks, Hansen, Lerner and Johnson have proposed a complete and integrated model based on the Keynesian framework in which variables such as investment, national income, interest rates, demand and supply of money are interdependent and can be represented by the two curves called the IS and LM curves. This extensive Keynesian model is therefore known as IS-LM curve model. In this model, they have shown how the level of national income and interest rate are jointly determined by the simultaneous balance in the two interdependent goods and money markets. Now this IS-LM curve model has become a standard tool of macroeconomics and the effects of monetary and fiscal policy are being discussed using this IS and LM curves model. Goods Market Equilibrium: The distraction of the curve: The IS-LM curve model emphasizes the interaction between goods and money markets. The goods market is balanced when total demand is equal to income. Total demand is determined by the demand for consumption and the demand for investment. In the Keynesian model of the commodity market balance, we now also have interest rates as an important determinant of investment. With this introduction of interest as a determinant of investment, the interest rate now becoming an endogenous variable in the model. When interest rates fall, the level of investment increases and vice versa. Changes in interest rates therefore affect the overall question of whether to cause aggregate expenditure by causing changes in investment demand. When interest rates fall, it reduces the investment projects of costs c and thus increases the profitability of the investments. The businessmen will therefore invest more at a lower interest rate. The increase in demand for investment will lead to an increase in total demand, which in turn will increase the level of revenue. In the distraction of the IS curve, we try to find out the equilibrium level of national income, as determined by the balance of the goods market by an investment level determined by a certain interest rate. For example, the IS curve relates different levels of national income with different interest rates. As explained above, the planned investment, with a fall in interest rates, will cause an upward shift in the overall demand function (C + 7), leading to a balance in the goods market at a higher level of Income. The lower the interest rate, the higher the equilibrium level of national income. For example, the IS curve is the locus of those interest rate and the level of national income at which the goods market is balanced. How the IS curve is derived is illustrated in fig. 24.1. Panel (a) of fig. 24.1 depicts the relationship between interest rate and planned investment by the investment question curve II. Panel (a) will show that at interest rate Or0 the planned investment is equal to OI0. With OI0 as the amount of the planned investments is the total demand curve C +I0, which, as will be seen in panel b) of fig. 24.1, is equal to the total production at OY1 level of national income. Therefore, in the panel (c) at the bottom of the Fig. 24.1, at the interest rate Or2, a level of income equal to OY0 has been plotted. Now, if interest rates fall to Or2 the planned investment by businessmen rises from OI0 to OI1 [see panel (a)]. With this increase in planned investments, the overall demand curve shifts to the new position C + 11 in panel (b) and the goods market is balanced at OY1 level of national income. For example, in panel (c) at the bottom fig. 24.1 the level of national income OY1 is plotted at the interest rate, Or1. With a further reduction in interest to Or2, the planned investment rises to OI2 (see panel a). With this further increase in planned investments, the overall demand curve in panel (b) shifts to the new position C + I2 corresponding to the market of goods balanced at OY2 income level. Therefore, in panel (c) the equilibrium income OY2 is displayed at the interest rate Or2. By joining points A, B, D which represent different interest income combinations where the goods market is balanced, we obtain the IS Curve. From fig. 24.1 it will be noted that the IS curve is downward (i.e. a negative slope) implying that when interest rates fall, the equilibrium level of national income increases. Why is curve slope down? Which explains the downwardly sloping nature of the IS curve. As can be seen above, the fall in interest rates leads to an increase in planned capital expenditure. The increase in capital expenditure causes the overall demand curve to shift upwards and therefore leads to an increase in the equilibrium level of national income. A lower interest rate is therefore accompanied by a higher national income and vice versa. As a result, the IS curve, which holds the income level with the interest rate, is falling. The steepness of the IS curve depends on (1) the elasticity of the investment demand curve and (2) the size of the multiplier. The elasticity of investment demand means the degree of responsiveness of capital expenditure to the changes in the interest rate. If the investment demand is very elastic or reacts to the changes in interest rates, then a fall in interest rates a large increase in investment demand, which in turn will cause a major upward shift in the overall demand curve. A major upward shift in the overall demand curve will lead to a large expansion of national income. Thus, when the demand for investment is more elastic for the changes in interest rates, the investment demand curve will be relatively flat (or less steep). Even if demand for investment is not very sensitive or elastic to changes in interest rates, the IS curve will be relatively steeper. The steepness of the IS curve also depends on the size of the multiplier. The value of multiplier depends on the marginal tendency to consume (mpc). It can be noted that the higher the marginal tendency to consume, the overall demand curve (C+I) will be steeper and the magnitude of the multiplier will be large. In the case of a higher marginal tendency to consume (mpc) and therefore a higher value of multiplier, a certain increase in investment demand due to a certain decrease in

interest rates will contribute to a greater increase in the equilibrium level of income. So, the higher the value of multiplier, the greater will the increase in balance income produced by a certain drop in interest rates and this makes the IS curve flatter. On the other hand, the smaller value of the multiplier due to a lower marginal tendency to consume, the smaller will be the increase in the equilibrium level of income after a certain increase in investments due to a certain decrease in interest rates. So, in the case of smaller size of multiplier the IS curve will be more steep. Shift in IS Curve: It's important to understand what determines the position of the IS curve and what causes shifts in it. It is the level of autonomous spending that determines the position of the IS curve and changes in autonomous spending are causing a shift in it. By organic expenditure, we mean expenditure, whether it is capital expenditure, public expenditure or consumer spending that is not dependent on the level of income and the interest rate. Public spending is an important type of autonomous expenditure. Note that public spending, which is determined by various factors and by government policy, does not depend on the level of income and interest rates. Similarly, some consumer spending must be made if individuals are to survive, even by borrowing from others or by spending their savings over the past year. Such consumer spending is a kind of autonomous expenditure and changes in this do not depend on changes in income and interest rates. Furthermore, autonomous changes in investment may also occur. the balance of the goods market of the simple Keynesian model, capital expenditure is treated as autonomous or independent of the income and therefore does not vary as the level of income increases. However, in the entire Keynesian model, capital expenditure is considered to be determined by the interest rate and the marginal efficiency of investments. As a result of this entire Keynesian model, in the distraction of the IS curve, we consider the level of investment and the changes in it as determined by the interest rate and the marginal efficiency of the capital. However, there may be changes in capital expenditures autonomously or independently of changes in interest rates and the level of income. For example, the growing population requires more investment in housing, school buildings, roads, etc., which are not dependent on changes in income level or interest rate. Furthermore, autonomous changes in capital expenditure can take place when new innovations are achieved, i.e. when there is progress in technology and new machines, equipment, tools, etc., which embodies the new technology. Moreover, public expenditure is also autonomous, as they are not dependent on income and interest rates in the economy. As we know, the government is increasing its spending to promote social prosperity and accelerate economic growth. An increase in government spending will lead to a right-wing shift in the IS curve. Money Market Equilibrium: Distraction of LM Curve: Distraction from the LM Curve: The LM curve can be derived from Keynesian theory from the analysis of money market balance. According to Keynes, the demand to keep money depends on motive transactions and speculative motive. It is the money that is held for transactions motive that is a function of income. The higher the income level, the greater the amount of money that is held for transactions motive and thus higher the level of demand for money curve. The demand for money depends on the level of income, because they have to finance their expenditure, i.e. their transactions of buying goods and services. The demand for money also depends on the interest cost of keeping money. This is because by keeping money instead of loans and buying other financial assets, one should forgo interest. For example, the demand for money (Md) can be expressed as: Md – L(Y, r) Where Md stands for the demand for money, Y for real income and r for interest. Thus, we can draw a family of money demand curves at different levels of income. Now, the intersection of these different money demand curves with the supply curve of money established by the monetary authority would give us the LM curve. The LM curve brings the level of income associated with the interest rate is determined by the balance in the money market corresponding to different levels of demand for money. The LM curve explains what the different interest rates will be (given the of money and the family of demand curves for money) at different levels of income. But the money demand curve, or what Keynes calls the liquidity preference curve alone, can't tell us exactly what the interest rate will be. In fig. 24.2 (a) and b) we derived the LM curve from a family of demand curves for money. As revenues rise, the demand curve shifts outwards, and so the interest rate that equates the money supply shifts, with the demand for money increasing. In Figure 24.2 (b), we measure the income on the X axis and determine the level of income corresponding to the different interest rates determined at those income levels through money market balance through the equality of demand for and money supply in fig. 24.2 (a). Slope of LM Curve: It will be noted from fig. 24.2 (b) that the LM curve slopes up to the right. This is because with higher levels of income, demand curve for money (Md) is higher and thus the money-market balance, that is, the equality of the given money supply with money demand curve occurs at a higher interest rate. This means that interest rates vary directly with income. It is important to know what factors the slope of the LM curve depends on. There are two factors on which the slope of the LM curve depends. First, the responsiveness of demand for money (i.e. liquidity preference) to changes in income. As income increases, say from Y0 to Y1 the demand curve for money shifts from Md0 to Md1 i.e., with an increase in income, the demand for money would increase before being held for transactions motive, Md or L1=f(Y). This additional demand for money would distort the balance in the money market and, for the rebalancing, interest rates will rise to the level at which the given money supply curve crosses the new demand curve corresponding to the higher level of income. It is worth noting that in the new equilibrium position, with the given stock of the money supply, money held under the transactions motive will increase, while the money held for speculative motive will decrease. The greater the demand for transactions that leads to an increase in income, the greater the decrease in the money supply available for speculative motive and, given the demand for money for speculative motive, the higher the increase in the tie rate of interest rate and thus the steeper the LM curve, r=f (M2 L2) where is the interest rate of interest rates , M2 is the stock of money available for speculative motive and L2 is the demand for money or liquidity preference for speculative motive. The second factor that determines the slope of the LM curve is the elasticity or responsiveness of the demand for money (i.e. liquidity preference for speculative motive) to the changes in the The lower the elasticity of the liquidity preference for speculative motive with regard to the interest rate, the steeper the LM curve will be. On the other hand, if the elasticity of liquidity preference (money demand function) to the changes in interest rate is high, the LM curve will be flatter or less steep. Shifts in the LM Curve: Another important thing to know about the IS-LM curve model is that which leads to shifts in the LM curve or, in other words, what determines the position of the LM curve. As seen above, an LM curve is pulled by holding the stock or money supply. Therefore, when the money supply increases, given the money demand function, the rate of interest will decrease at the given level of income. This is because with fixed income, interest rates must fall, so the demand for money for speculative and transactions motive increases to become equal to the larger money supply. As a result, the LM curve shifts outwards to the right. The other factor causing a shift in the LM curve is the change in liquidity preference (money demand function) for a given income level. If the liquidity preference function for a certain level of income shifts upwards, this will lead to an increase in the interest rate for a given income level, given the money supply. This will lead to a shift in the LM curve to the left. It follows from above that the increase in the money demand function causes the LM curve to shift to the left. If the demand for money for a certain level of income decreases, it will lower the interest rate for a given income and thus shift the LM curve to the right. The LM Curve: The essential features: From our analysis of the LM curve, we arrive at the following essential characteristics: 1. The LM curve is a scheme that describes the combinations of interest rates and the level of income where the money market is balanced. 2. The LM curve runs to the right. 3. The LM curve is flatter as the interest rate elasticity of demand for money is high. On the contrary, the LM curve is steep when the demand for money for interest rate elasticity is low. 4. The LM curve shifts to the right when the stock of money is increased and it shifts to the left as the money supply inventory is reduced. 5. The LM curve shifts to the left if there is an increase in the money demand function that increases the amount of money requested at the given interest rate and income level. On the other hand, the LM curve shifts to the right if there is a decrease in the money demand function that reduces the amount of money requested at certain levels of interest and income. Simultaneous balance of the goods market and the money market: the IS and LM curves relate to the two variables: (a) Income and (b) The interest rate. The income and the interest rate are thus determined together at the intersection of these two curves, E in Fig. Fig. The equilibrium rate of interest thus is Or2 and the level of the income set is OY2. In this respect, the income and interest rate are such that (1) the goods market is in balance, i.e. total demand is equal to the level of total production, and (2) the demand for money is balanced with the money supply (i.e. the desired amount of money is equal to the actual supply of money). It should be noted that LM cur/e is attracted by the provision of money to hold. Thus, the IS-LM curve model is based on: (1) The function of investment demand, (2) The consumption function, (3) The demand for money and (4) The amount of money. So we see that according to the IS-LM curve model, both the real factors, namely saving and investing, the productivity of capital and the tendency to consume and save, as well as the monetary factors, i.e. the demand for money (liquidity preference) and the supply of money, play a role in the joint determination of interest rates and the level of income. Any change in these factors will lead to a shift in IS or LM curve and will therefore change the equilibrium levels of interest rates and earnings. The IS-LM curve model described above has succeeded in integrating the theory of money with the theory of income determination. And by doing so, as we will see below, it has succeeded in synthesising monetary and fiscal policy. Furthermore, the IS-LM curve analysis makes it easier for us to explain the impact of changes in certain key economic variables such as the desire to save, the money supply, investment, the demand for money on interest rates and the level of income. Effect of changes in money supply on the interest rate and income level: Let us first consider what will happen if the money supply is increased by the action of the Central Bank. Given the liquidity preference schedule, with the increase in money supply, more money will be available for speculative motive at a certain level of income, which will reduce interest rates. As a result, the LM curve will shift to the right. With this right-hand shift in the LM curve, in the new equilibrium position, interest rates will be lower and the level of income will be greater than before. This can be seen in Fig. 24.4 where with a certain amount of money, LM and IS curves intersect at point E. With the increase in money supply, the LM curve shifts to the right to the position LM', and since the IS scheme remains unchanged, new equilibrium at point G corresponds to which interest rate is lower and the income level is higher than at E. Suppose that the Country's Central Bank takes measures to increase the money supply instead of increasing the money supply to reduce the amount of money With the reduction in the money supply, there will be less money available for speculative speculative and as a result, the LM curve will shift to the left of E, and the IS curve will remain unchanged, in the new equilibrium position (as shown in point T in fig. 24.4) interest rates will be higher and the level of income smaller than before. Changes in desire to save or tendency to consume: Let's consider what happens to interest when the desire to save or in other words, tends to consume changes. When people's desire to save decreases, that is, when the tendency to consume increases, the overall demand curve will shift upward and therefore the level of national income will rise at any interest rate. As a result, the IS curve shifts to the right. In Fig. 24.5 suppose that with a certain decrease in desire to save (or tend to consume) increases, the IS curve shifts to the right to is' dotted position. As the LM curve remains unchanged, the new equilibrium position will be set at H corresponding to the interest rate and the income level will be greater than with E. On the other hand, if the desire to save rises, that is, if the tendency to consume declines, the overall demand curve will shift downwards, causing the level of national income to fall for each interest rate and as a result, the IS curve will shift to the left. With this, and LM curve remaining unchanged, the new equilibrium position will be achieved on the left side of E, for example at point L (as indicated in fig. 24.5) corresponding to which both the interest rate and the level of national income will be smaller than with E. Changes in autonomous investment and public expenditure: Changes in autonomous investment and public spending will also shift the IS curve. If there is an increase in autonomous private investment or the government increases its expenditure, the overall demand for goods will increase and this will lead to an increase in national income through the multiplier process. This will shift is schedule to right, and given the LM curve, interest rates and the level of revenue will rise. On the contrary, if private capital expenditure somehow falls or the government reduces its spending, the IS curve will shift to the left and, given the LM curve, both the interest rate and the income level will fall. Changes in the preference for money or liquidity: Changes in liquidity preference will bring about changes in the LM curve. If the liquidity preference or the demand for money of the people increases, the LM curve will shift to the left. This is because a demand for money, given the amount of money, will increase interest rates corresponding to each level of national income. With the left-hand shift in LM curve, given the IS curve, the national income will fall. On the contrary, if the demand for money or liquidity preference of the people decreases, the LM curve will shift to the right. This is because, given the money supply, the right-wing shift in the money demand curve means that it corresponds to each income level, there will be a lower interest rate. With a right-wing shift in the LM curve, given the IS curve, the equilibrium level of interest rates will fall and the equilibrium level of national income will increase. So we see that changes in the tendency to consume (or want to save), autonomous investment or government spending, the supply of money and the demand for money affect not only interest rates and income but also the IS-LM curve model clearly shows that the government can influence economic activity or the level of national income through monetary and fiscal measures. By adopting an appropriate monetary policy (i.e. changing the money supply), the government can shift the LM curve and by implementing an appropriate fiscal policy (expenditure and tax policy) the government can shift the IS curve. For example, both monetary and fiscal policy can play a useful role in regulating the level of economic activity in the country. Criticism of the IS-LM Curve Model: The IS-LM curve model makes significant progress in explaining the simultaneous determination of interest rates and the level of national income. It represents a more general, inclusive and realistic approach to the determination of interest rates and income levels. Furthermore, the IS-LM model succeeds in integrating fiscal integration and synthesis with monetary policy, and theory of income determination with the theory of money. But the IS-LM curve model is not without limitations. First, it is based on the assumption that interest rates are fairly flexible, i.e. free to vary and not rigidly set by the Central Bank of a country. If the interest rate is quite inflexible, then the correct adjustment above will not take place. Secondly, the model is also based on the assumption that investments are interest rate elastic, i.e. investments vary with interest rates. If investments are interest-inelastic, then the IS-LM curve model breaks down because the required adjustments do not take place. Third, Don Patinkin and Milton Friedman have criticized the IS-LM curve model as artificial and over-amazing. According to them, the division of the economy into two sectors – monetary and real – is artificial and unrealistic. According to them, monetary and real sectors are fairly intertwined and trade and they're on top of each other. Patinkin also pointed out that the IS-LM curve model price level of raw materials. According to him, the various economic variables, such as money supply, tend to consume or save, investment and demand for money affect not only interest rates and the level of national income, but also the prices of raw materials and services. Patinkin has proposed a more integrated and general equilibrium approach that implies not only interest rates and income levels, but also the prices of raw materials and services. IS-LM Curve Model: Explanation role of government fiscal and monetary policy: Using IS-LM curve model we can explain how the intervention of the government with good fiscal and monetary policy can affect the level of economic activity, i.e., income and employment level. Below we explain the impact of changes in fiscal and monetary policy on the economy in the IS-LM model. Impact of fiscal: Let's first explain how is-LM model shows the effect of an increase in public spending on income. This is illustrated in Fig. 24.6. As explained above, the increase in government expenditure of an autonomous nature increases overall demand for goods and services, causing an outward shift in the IS curve, as shown by fig. 24.6, where an increase in government spending leads to the shift of the IS curve from IS1 to IS2 Note that the horizontal distance between the two IS curves is equal to ΔG x 1/1 –MPC), showing the increase in revenues in keynes' multiplier effect. It will be seen from Fig. 24.6 that with the LM curve remaining unchanged, the new IS2 curve crosses LM curve at point B. In the IS-LM model with the increase in government expenditure (AG) the balance thus goes from point E to B and thus the interest rate rises from r1 to r2 and the income level from Y1 to Y2. For example, the IS-LM model shows that the expansionary fiscal policy of an increase in public expenditure increases both income levels and interest rates. It is worth noting that in the IS-LM model increase in national income with Y1Y2 in fig. 24.6 is less than EK which would occur in the model of Keynes. This is because Keynes in its simple multiplier model (popularly called Keynesian cross-model) assumes that investments are fixed and autonomous, while is-LM model takes into account the decline in private investment as a result of the rise in interest rates that is taking place with the increase in public spending. That is, increasing public spending squeezed out some private investment. Similarly, it can be shown that the reduction in public spending will lead to a shift of the right department in the IS curve, and given the unchanged, will lead to the decrease in both interest rates and the level of income. It should be noted that the government often reduces spending to reduce inflation in the in taxes: An alternative measure of expansionary fiscal policy that can be adopted is the reduction of taxes which, by increasing people's disposable income, increases people's consumption demand. As a result, a reduction in taxes will shift the IS curve to the right, as seen in Fig. 24.7, from IS1 to IS2. However, it may note that the Keynesian multiplier determines the horizontal shift in IS curve by the value of the tax multiplication equal to ΔT x MPC/1 – MPC and ensures that the income level increases with EH. However, in the IS-LM model, with the shift of the IS curve from IS1 to IS2 after the tax cut, the economy is moving from equilibrium point E to D and as shown by fig. 24.7, interest rates are rising from r1 to r2 and income levels are rising from Y1 to Y2. On the other hand, if the government intervenes in the economy to reduce inflationary pressures, it will raise the rates of personal taxes to reduce people's disposable income. The increase in personal taxes will lead to a decrease in overall demand. A fall in overall demand will help control inflation. This case can also be displayed by IS-LM curve model. Impact of monetary policy: Appropriate changes in monetary policy allow the government to influence the level of economic activity. Monetary policy can also be expansionary or downsizing, depending on the prevailing economic situation. IS-LM model can be used to demonstrate the effect of expansive and tight monetary policy. As explained above, a change in the money supply causes a shift in the LM curve; expansion in the money supply shifts it to the right and the money supply decreases it shifts to the left. Suppose the economy is in the grip of recession, the government (through its Central Bank) adopts the expansive monetary policy to lift the economy out of recession. For example, it is taking measures to increase the amount of money in the economy. The increase in money supply, the preference of liquidity or the demand for money remains unchanged, will lead to a decrease in interest rates. With lower interest rates, more investments will be made by businessmen. More investment will lead to an increase in overall demand and income. This means that with the expansion of the money supply LM curve will shift to the right as shown in Fig. 24.8.As a result, the economy will move from equilibrium point E to D and thus interest rates will fall from r1 to r2 and national revenues will rise from Y1 to Y2. So, IS-LM model shows the expansion of the money supply interest and increases income. We have also indicated what is called monetary transmission mechanism, that is, how IS-LM curve model shows the expansion of money supply leading to the increase in overall demand for goods and services. So we have seen that an increase in the money supply reduces the interest rates that more investment demand. The demand for investments through the multiplier process leads to a greater increase in total demand and national income. If the economy suffers from inflation, the government will gladly control it. Then its Central Bank would have to pursue a tight or shrinking monetary policy. That is, it should reduce the money supply. IS-LM model can be used to demonstrate, as we have seen above in the case of expansive monetary policy, that a reduction in the money supply will lead to a left-wing shift in the LM curve and lead to the rise in interest rates and the decrease in income levels. Income.