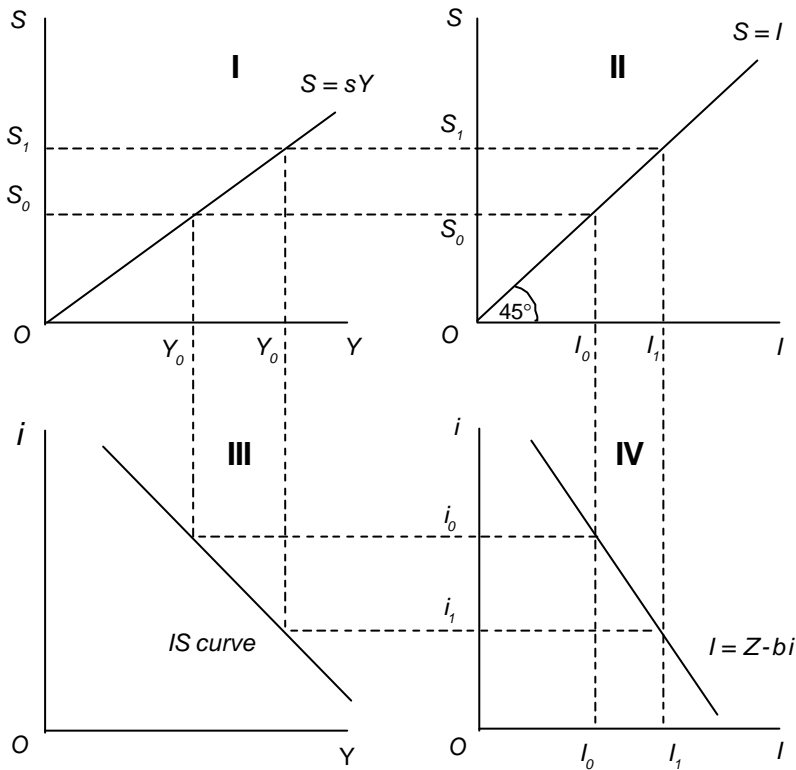


causes the curve to be flatter, while increases in the savings propensity,  $s$ , or tax rate,  $t$ , have the same effect. Notice, too, that a new series of  $Y$  values for  $i$  is generated (the  $IS$  curve will shift) for any change in  $Z$  or  $G$  and the extent of the shift is given by  $1/(s + t)$ , the 'full multiplier' effect.

Figure A1: Derivation of the  $IS$  curve



The same result can be achieved with a four quadrant diagram of the kind drawn in Figure A.1. To simplify the labelling of the diagram, we assume that a fixed amount of government spending is included in quadrant IV. The 'investment' schedule is really an 'investment plus government spending' schedule corresponding to equation A.3. Similarly, the 'savings' schedule in quadrant I is a 'savings plus taxation' schedule corresponding to equation A.4). At a rate of interest,  $i_0$ , injections in quadrant IV (including the interest sensitive component of investment) require a matching level of withdrawals indicated by  $S_0$ . These are forthcoming, in quadrant I, at a level of income  $Y_0$ . A fall in interest rates to  $i_1$  induces some increase in injections — how much depends on the interest elasti-