

Output supply curve in the Keynesian Coordination model

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1 Deriving the output supply curve

The middle-left figure is just a 45-degree line. The middle-right figure is the production function, which now exhibits increasing returns to scale. This means that labour demand (bottom figure) is upward-sloping. Labour supply is as you have covered already.

- Starting in the labour market for a specific interest rate r_1 , trace the points back to the top diagram and choose a point for r_1 .
- Now choose a higher interest rate, r_2 : this causes labour supply to increase in the labour market diagram so employment and wages fall. Trace the points back to the top diagram and you have a downward output supply curve.

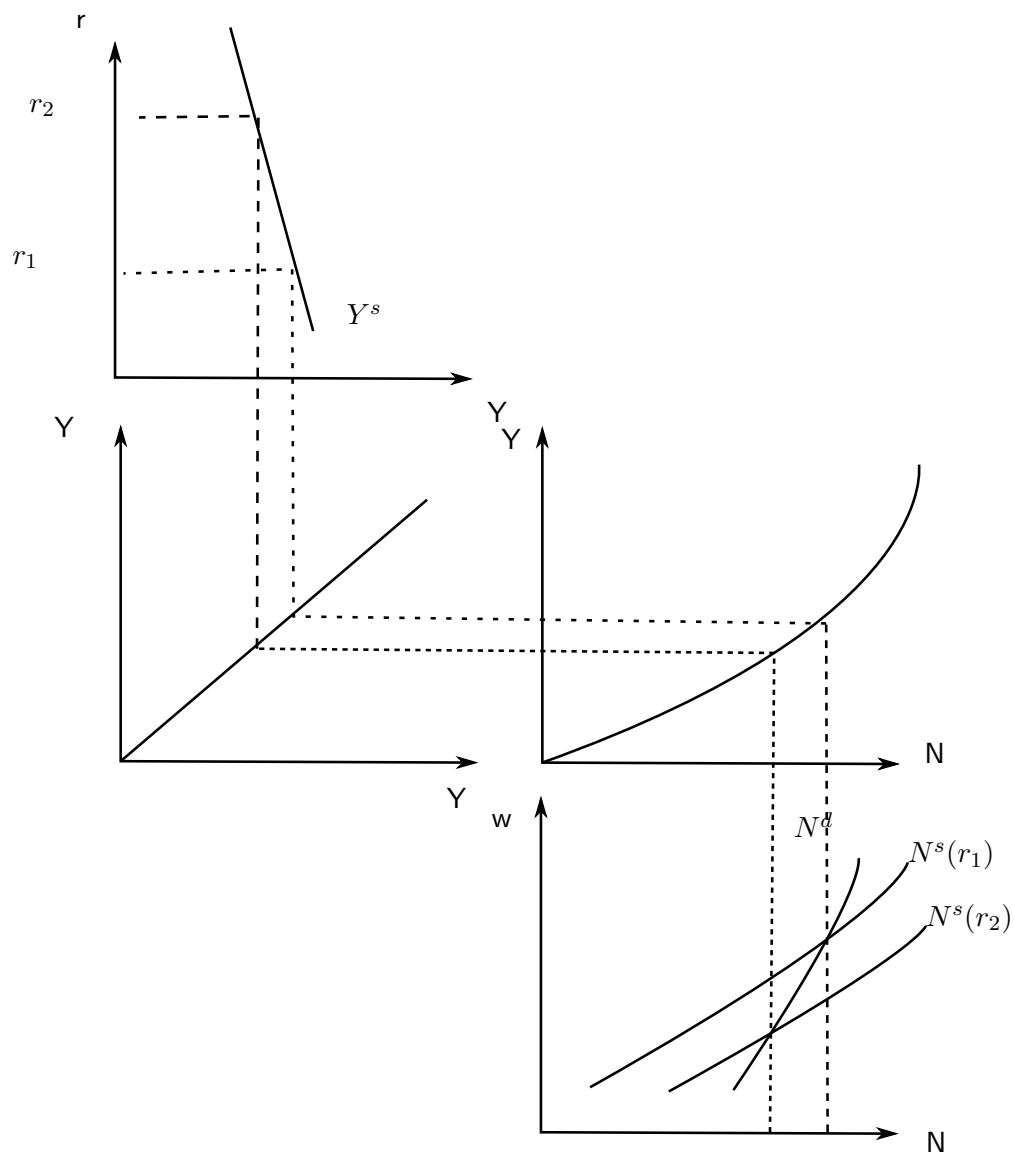


Figure 1: Output supply in the Keynesian coordination failure model