

Graphical Representation of the Two-Market Model Solution

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Move from behavioural AD curve to pure AD curve.

$$\begin{cases} y = y^d = \sigma(x) [y^s + \mu/p] \\ y = y^s \end{cases}$$

$$\rightarrow y = \sigma(x) [y + \mu/p]$$

$$[1 - \sigma(x)] y = \sigma(x) \frac{\mu}{p}$$

$$y = \frac{\sigma(x)}{1 - \sigma(x)} \cdot \frac{\mu}{p}$$

where $\sigma(x) \stackrel{MS}{=} \frac{x^\xi (1 + \tau(x))^{1-\xi}}{1 + x^\xi (1 + \tau(x))^{1-\xi}}$

$$y = \frac{x^\xi}{[1 + \tau(x)]^{\xi-1}} \cdot \frac{\mu}{p}$$

Pure AD

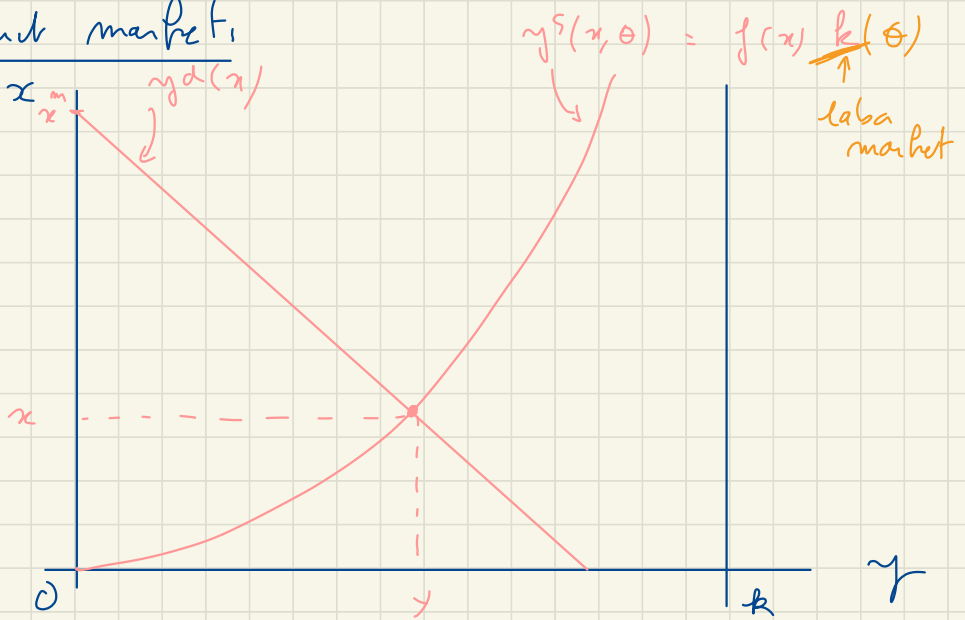
$$y^d(x) = \frac{x^\xi}{[1 + \tau(x)]^{\xi-1}} \frac{\mu}{p}$$

Model solution:

$$\begin{cases} \underline{y^d(x) = y^s(x, \theta)} \\ \underline{y = y^d(x)} \\ \underline{y^d(x, \theta) = y^s(\theta)} \\ \underline{y = y^s(\theta)} \end{cases}$$

Graphical representation of solution w/ 2 diagrams

Product market:



Labor market:

