

CHAPTER 31 : Aggregate Supply

Key terms

1. Aggregate supply curve : the relationship between the average level of prices in the economy and the level of the output.
2. Full capacity : the level of output where no extra production can take in the long run with existing resources.
3. Long-run aggregate supply curve : the aggregate supply curve that assumes that wage rates are variable, both upward and downwards.
4. Output gap : the difference between actual level of GDP and the productive potential of the economy.
5. Short-run aggregate supply curve : the upward sloping aggregates supply curve that assumes that money wage rates are fixed.



1. Aggregate supply

Aggregate Supply

Short run

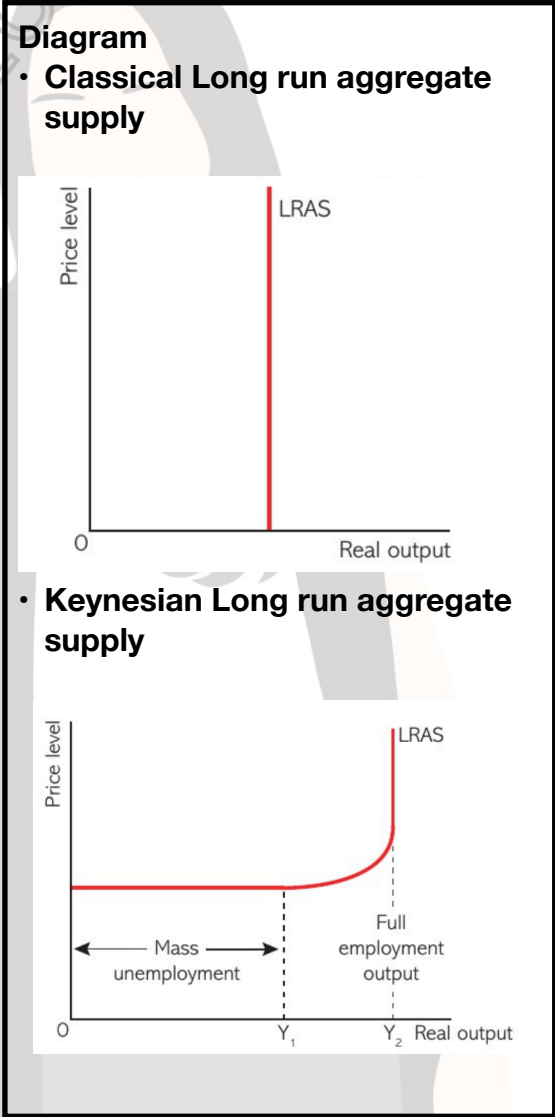
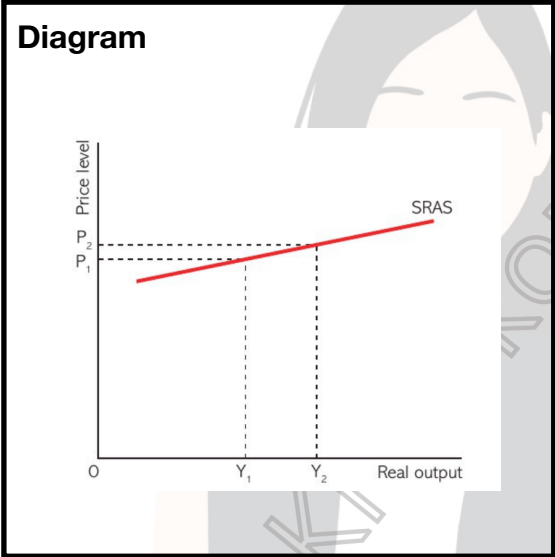
Long run

Assumption

- When money wage rates and prices of all other factor inputs in the economy are fixed.
- Short-run aggregate supply is relatively price elastic

Assumption

- All factors of production can be varied over the period of time



Factors shift short-run aggregate supply (Shift right)

• **Wage rates**

: Lower wage, lower cost of production

: SRAS shifts right

• **Raw material prices**

: Lower cost of raw material, lower cost of production

: SRAS shifts right

• **Taxation**

: Decrease in tax burden will decrease cost

: SRAS shifts right

• **Exchange rates**

: If exchange rate increases, price of imported goods is likely to decrease

: SRAS shifts right

Factors shift Long-run aggregate supply (Shifts right)

• **Technological advances**

: It can increase productivity

: LRAS shifts right

• **Changes in government regulations**

: eg. If government makes it simpler to set up a company, it could encourage more entrepreneurs to create companies and more output will be produced.

: LRAS shifts right

• **Demographic changes and migration**

: If there is higher no. of immigration, more no. of labour

: LRAS shifts right

• **Competition policy**

: Competition is likely to force firms to be more productive and reduce their cost

: more innovative producing new products

: LRAS shifts right

• **Factor mobility**

: Increases in factor mobility are likely to increase LRAS