

Aggregate Supply

Presented by

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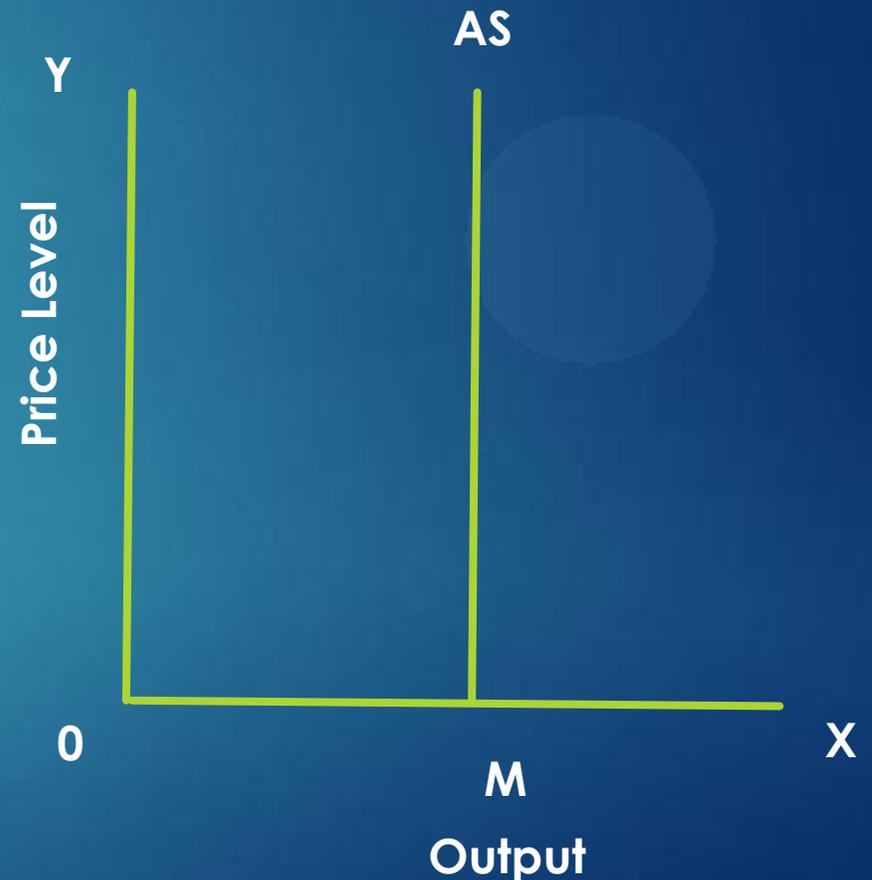
Meaning

- ▶ AS refers to the total supply of goods and services in the economy in a year
- ▶ It refers to the planned aggregate supply/output in the economy
- ▶ AS is defined in two ways- Classical Concept and Keynesian concept of Aggregate Supply

Classical Concept of Aggregate Supply

- ▶ According to Classical economists (Adam Smith, A.C. Pigou), AS is perfectly inelastic with respect to the price level
- ▶ The changes in the price level have no impact on the AS
- ▶ AS is Aggregate Supply curve which is a vertical line
- ▶ They believe that AS would always be at full employment level
- ▶ At full employment level, the economy is capable of producing maximum level of output

Classical Aggregate Supply Curve



Two Assumptions of Classical Concept of AS

Say's Law of Market-----

- J.B. Say.... States that supply creates its own demand
- If goods are produced, there will be automatically a market for them
- No situation of overproduction

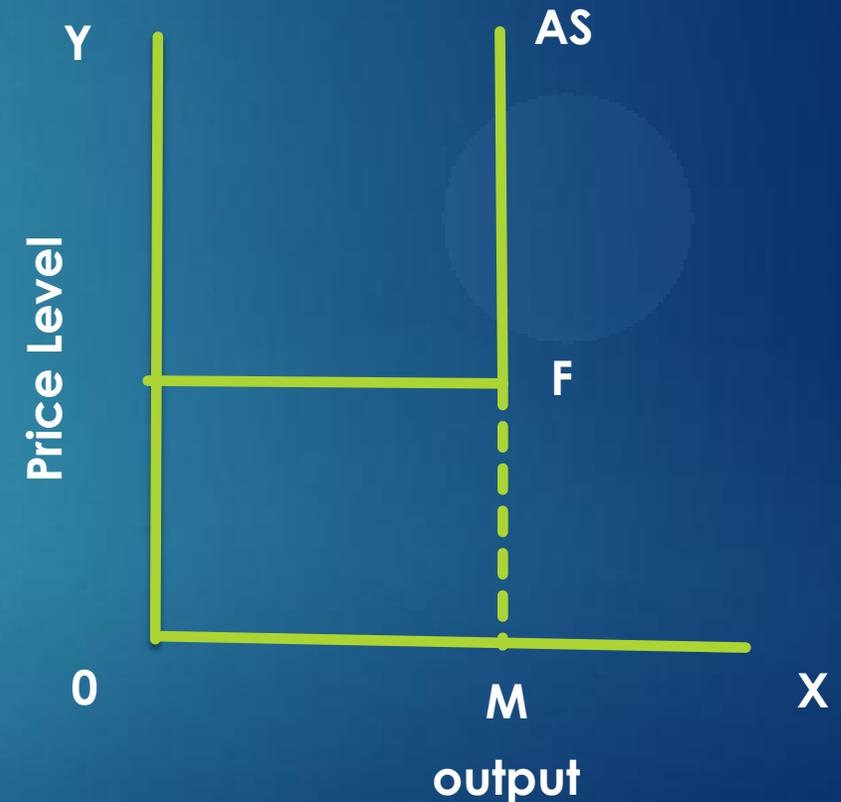
Wage-Price Flexibility-----

- It means real wages and prices are flexible
- They can increase or decrease freely
- Suppose, labour market is in disequilibrium due to excess demand, wage price flexibility can increase the wage rate as required, equilibrium is restored
- It ensures full employment and market for goods and services is in equilibrium

Keynesian Concept of AS

- ▶ According to Keynes, AS is perfectly elastic with respect to price level
- ▶ Producers are willing to supply any amount at fixed price level
- ▶ Output can be increased without any change in price level until the level of full employment is reached
- ▶ Up to the level of full employment, output can be increased by using excess capacity, prices remain constant
- ▶ As it reaches full employment level, no further increase in production is possible
- ▶ AS curve is a vertical straight line

Keynesian AS curve



- ▶ Aggregate Supply and NNP is the same thing
- ▶ A major part of the national income is spent on consumption and rest is saved
- ▶ So NI or AS is the sum total of consumption and saving in an accounting year
- ▶ Keynes divide AS into two parts---

$$AS = C + S$$

Consumption and Saving

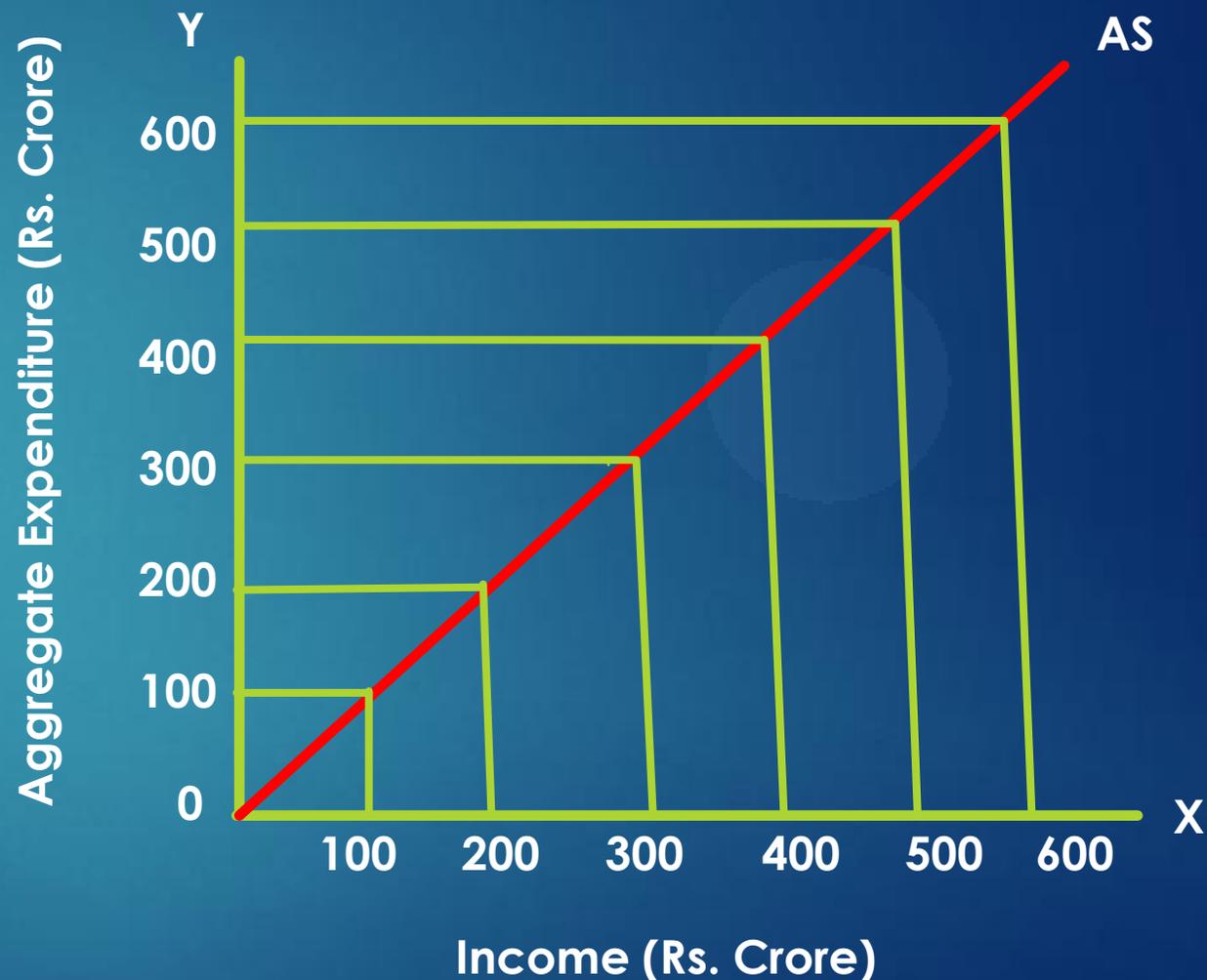
Aggregate Supply Schedule

Aggregate Supply	Consumption	Saving	Remarks
0	100	-100	C > Y
100	150	-50	
200	200	0	C = Y
300	250	50	C < Y
400	300	100	
500	350	150	
600	400	200	

- When consumption (C) exceeds income (Y), at lower levels of income $C > Y$ and hence S is negative
- At income level of 200, $C = Y$ and $S = 0$.
- Beyond that $C < Y$ and S is positive

Aggregate Supply Curve

- ▶ Technology remains unchanged in the short run
- ▶ Output can only be increased by making fuller utilization of existing resources
- ▶ So there is direct and proportionate relationship between employment and aggregate supply
- ▶ AS curve slopes upward
- ▶ Total income = total spending



THANK YOU

