

# Aggregate Supply

Coach Burnett  
AP Macroeconomics

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# Aggregate Supply

- [ The level of Real GDP ( $GDP_R$ ) that firms will produce at each Price Level (PL).
- Think suppliers on a national scale
  - i.e. How much output will all the producers in a country collectively make.

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# Long-run vs. Short-run

## Long-run

- Period of time where input prices are completely flexible and adjust to changes in the price-level
- In the long-run, the level of Real GDP supplied is independent of the price-level

## Short-run

- Period of time where input prices are sticky and do not adjust to changes in the price-level
- In the short-run, the level of Real GDP supplied is directly related to the price level

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# Long-run Aggregate Supply (LRAS)

- [ The Long-Run Aggregate Supply or LRAS marks the level of full employment in the economy (analogous to PPC).
- [ Because input prices are completely flexible in the long-run, changes in price-level do not change firms' real profits and therefore do not change firms' level of output. This means that the LRAS is vertical at the economy's level of full employment.

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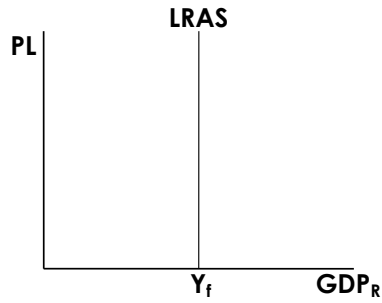
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## Long-run Aggregate Supply (LRAS)



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## Short-run Aggregate Supply (SRAS)

Because input prices are sticky in the short-run, the SRAS is upward sloping. This reflects the fact that in the short-run, increases in the price-level increase firm's profits and create incentives to increase output. As the price-level falls, firm's profits drop and this creates an incentive to reduce output.

About 99.999999% of all the shifts in Aggregate Supply we will ever make in this class will be dealing with Short-run.

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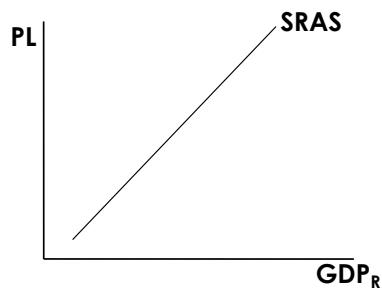
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## Short-run Aggregate Supply (SRAS)



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## Changes in SRAS

An increase in SRAS is seen as a shift to the right. SRAS →

A decrease in SRAS is seen as a shift to the left. SRAS ←

The key to understanding shifts in SRAS is per unit cost of production

**Per-unit production cost** =  $\frac{\text{total input cost}}{\text{total output}}$

\*\*know this formula\*\*

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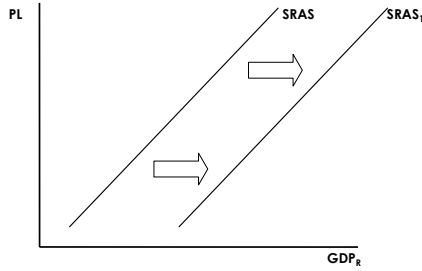
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## Changes in SRAS (Increase)



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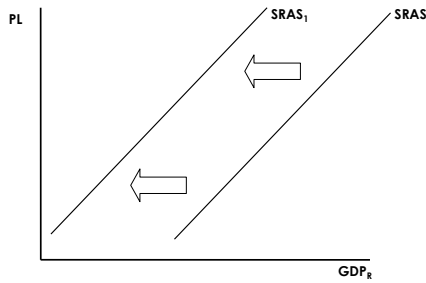
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## Changes in SRAS (Decrease)



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## Determinants of SRAS

- [Input Prices
- [Productivity
- [Legal-Institutional Environment

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## Input Prices

- [Domestic Resource Prices
  - Wages (75% of all business costs)
  - Cost of capital
  - Raw Materials (commodity prices)
- [Foreign Resource Prices
  - Strong S = lower foreign resource prices
  - Weak S = higher foreign resource prices
- [Market Power
  - Monopolies and cartels that control resources control the price of these resources
- [Increases in Resource Prices = SRAS ←
- [Decreases in Resource Prices = SRAS →

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# Productivity

— [  $\text{Productivity} = \frac{\text{total output}}{\text{total inputs}}$

— [ More productivity = lower unit production cost = SRAS →

— [ Lower productivity = higher unit production cost = SRAS ←

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# Legal-Institutional Environment

— [ Taxes and Subsidies

- Taxes (\$ to gov't) on business increase per unit production cost = SRAS ←

- Subsidies (\$ from gov't) to business reduce per unit production cost = SRAS →

— [ Government Regulation

- Government regulation creates a cost of compliance = SRAS ←

- Deregulation reduces compliance costs = SRAS →

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# Summary

— [ Aggregate Supply is looking at the level of Real GDP that firms will produce at each Price Level.

— [ Again, all increases are drawn to the right, and all decreases are drawn to the left.

— [ The key to understanding shifts in SRAS is per unit cost of production

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