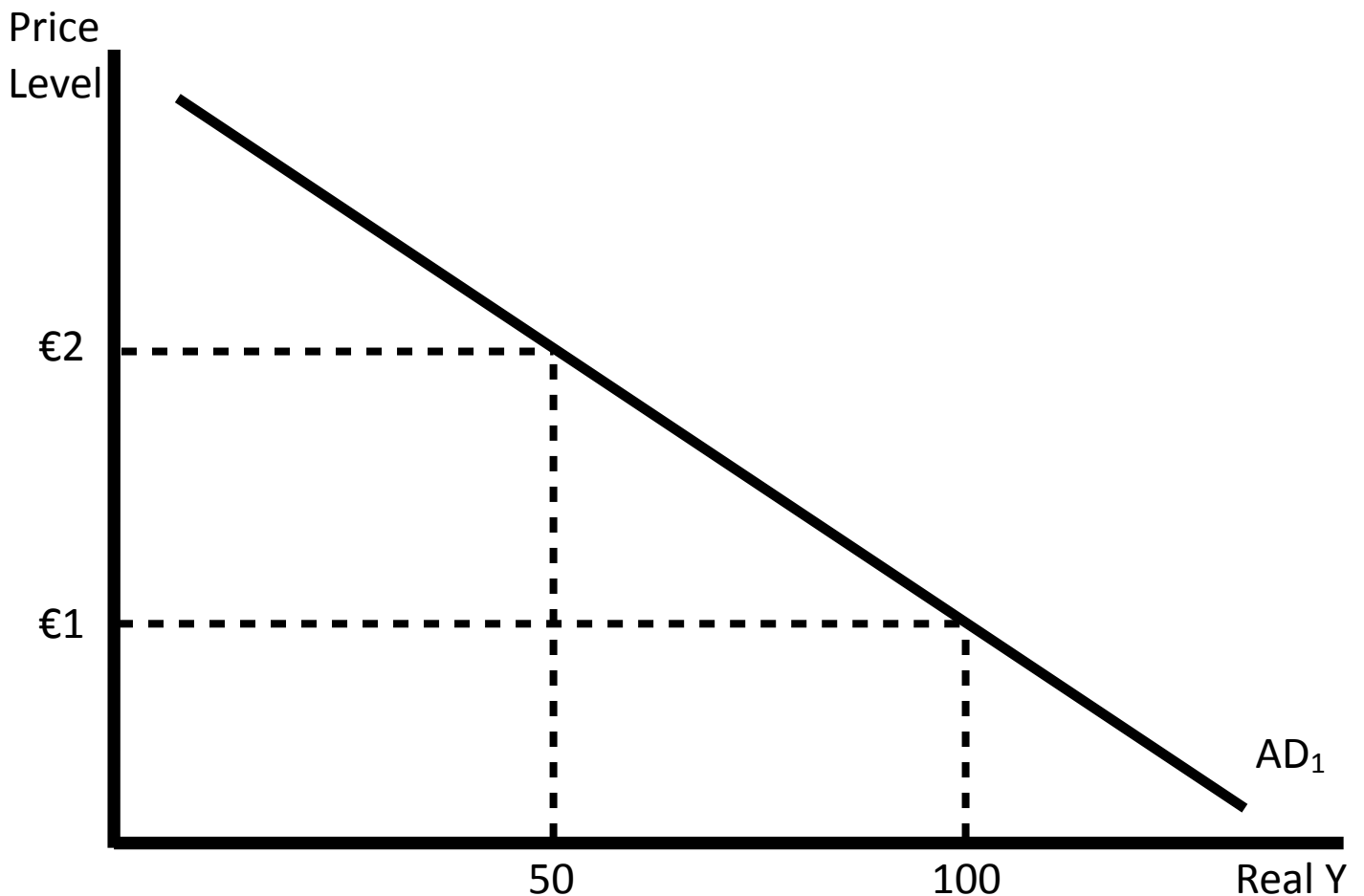


National Income

When talking about National, the most important point that one needs to keep in mind, from an Irish Leaving Cert point of view, is Aggregate Demand.

Loosely speaking, Aggregate Demand is how much stuff people are willing and able to buy at different price levels. Please don't be confused about the idea of the Price Level. All this means is that if prices fall on average (deflation) people can buy more things with the same amount of money. If the Price Level rises (inflation) people can buy less things with their money.

E.g. If I earn €100 euro a month and on average, things cost €1 each, then I can buy 100 items per month. If on the other hand prices rise to €2 and I am still earning €100 per month then I can only buy 50 items a month. See the Aggregate Demand Curve below.



The AD line above just shows how much people in general will spend at different prices, when the prices refer to all goods in the economy.

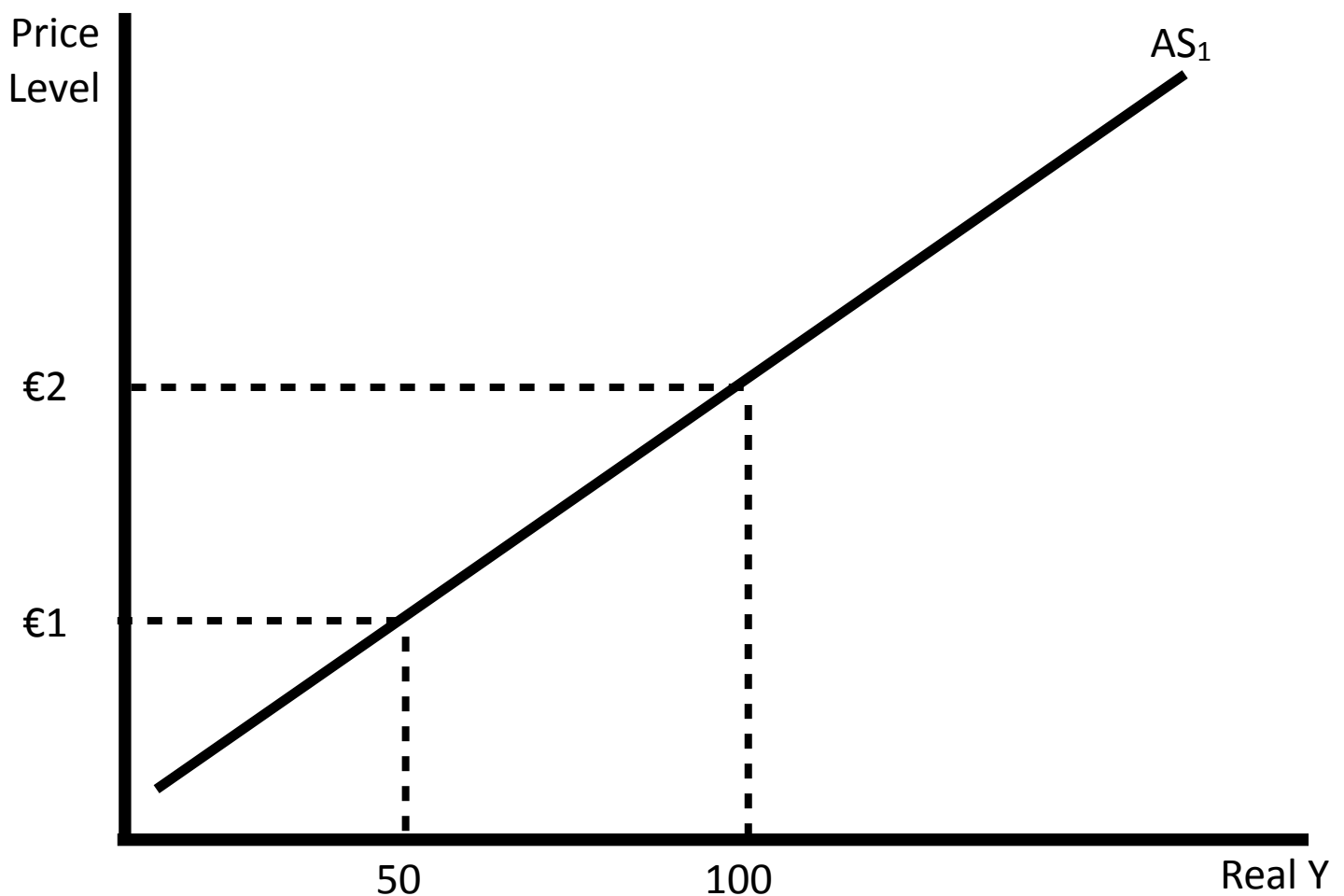
Hopefully, from reading the notes, we should know about Aggregate Supply. Aggregate Supply is the amount of goods and services that firms are willing and able to produce in an economy at different prices.

Surprisingly, this depends on the factors of production. The better the quality of factors of production in an economy, the more that they can produce in an hour. The more that can be produced in a given hour of work, the more consumer goods and services that firms can make available for sale.

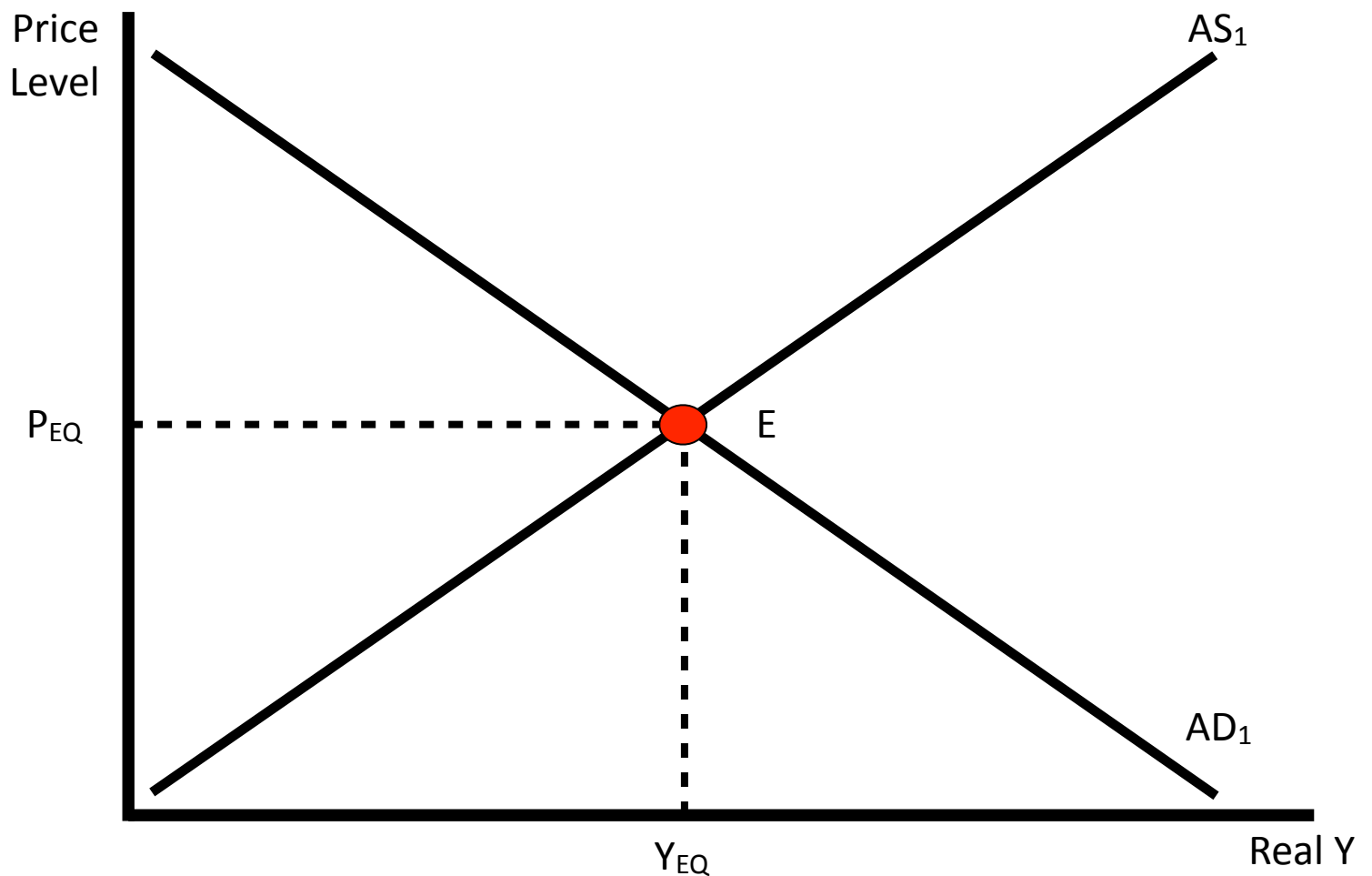
However, it does also depend on the Price Level. Firms will most likely be more willing to produce more goods and services if the prices that they receive for these goods and services are higher.

Therefore, the Aggregate Supply curve slopes upward.

E.g. If firms were receiving €1 for their goods they may only be willing and able to supply 50 items, but if the price that they could charge for their goods rose to €2 then they may be willing and able to supply 100 items.



Equilibrium in the economy occurs where $AD = Y$. That means that the amount that people want to buy is exactly equal to the amount of goods that firms are producing. This equilibrium occurs at the intersection of AD and AS. See below.



What we need to keep an eye on here is the Y_{EQ} at the bottom. We should know from reading the notes that how rich a country is depends on the quantity of goods and services that are produced. The Y_{EQ} is the amount of stuff that is produced in an economy. What any society would prefer is that the quantity of goods and services produced (Y_{EQ}) is as big as possible. This means that the Y_{EQ} is as far to the right as possible.

When we are talking about trying to improve an economy, we are trying to move this Y_{EQ} (the amount of stuff made by Irish firms) to the right.

Then a natural question follows which is how can we create more wealth, produce more goods and services, move Y_{EQ} further to the right? All of these are the same question.

The answer according to your Irish leaving cert course is Aggregate Demand. According to the Leaving cert, the economy is demand driven. That means that if you

want more goods to be produced, to alleviate poverty, to make a country, you need to increase the desire by all buying parties (consumers, investors, the government and foreigners) to buy more goods and services produced by Irish firms.

We will now analyse what is involved in Aggregate Demand.

Aggregate Demand

$$AD = C + I + G + (X - M)$$

What this means is that AD is made up of the addition of the desire to buy goods and services by

C: Consumers

I: Investors (Entrepreneurs or Business People)

G: The Government

X: Foreigners that buy our exports

M: AD is not increased when Irish people buy foreign produced goods.

Therefore, if we add the total amount spent by all consumers in an economy (except for the money Irish people spend on imports) we will find out the amount that consumers want to buy. When we find this out, we know that in equilibrium, $AD = Y$, which means that the amount consumers are buying is the same as the amount that firms are producing. So if consumers buy more (which represents an increase in Aggregate Demand), then more is produced and society is richer.

It is important that the opposite is also true. If people buy less goods and services (like during a recession), then less will be produced and the economy will be poorer.

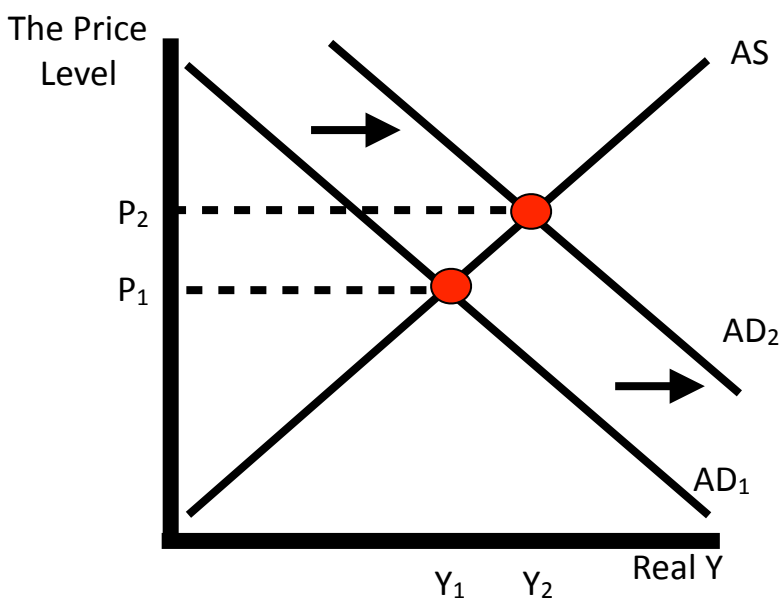
When looking at the notes you need to see what effects each of the five components of Aggregate Demand. This leads into the Circular Flow of Income. The relationship between The Aggregate Demand Curve, the Aggregate Demand Equation and The Circular Flow of Income is summarised in the following few pages.

The Aggregate Demand Equation and the Aggregate Demand Curve

We have three different measures of Aggregate Demand and a number of rules about the economy based on Aggregate Demand.

Looking at the Aggregate Demand equation $AD = C + I + G + (X - M)$, we have to look at the different factors that influence each of these components. Then we look at the diagram below.

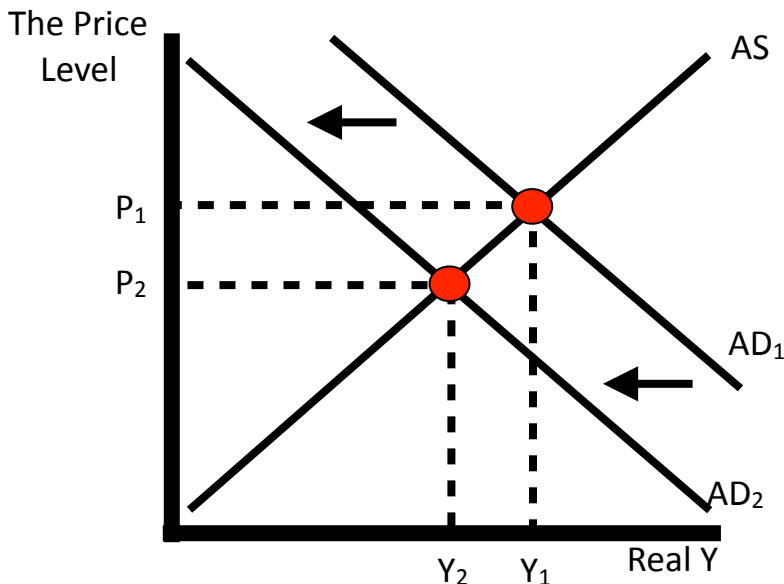
<h1>Aggregate Demand Rises if</h1>				
Consumption	Investment	Gov. Spending	Exports	Imports
Income ↑	Expectations ↑	Decisions of Politicians ↑	Foreign Incomes ↑	Irish Income ↓
MPC ↑	Rate of Interest ↓		Irish Competitiveness ↑	MPM ↓
Availability of Credit ↑			Value of Euro ↓	Value of Euro ↓
Rate of Interest ↓				
Tax ↓				



- Effect***
- 1) AD ↑
 - 2) P ↑
 - 3) Y ↑
 - 4) Emp ↑
 - 5) Sav ↑
 - 6) Imp ↑

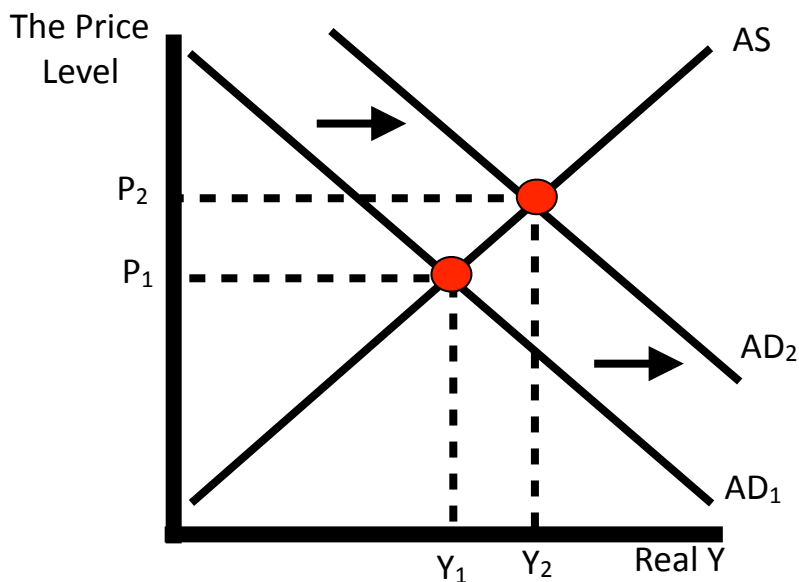
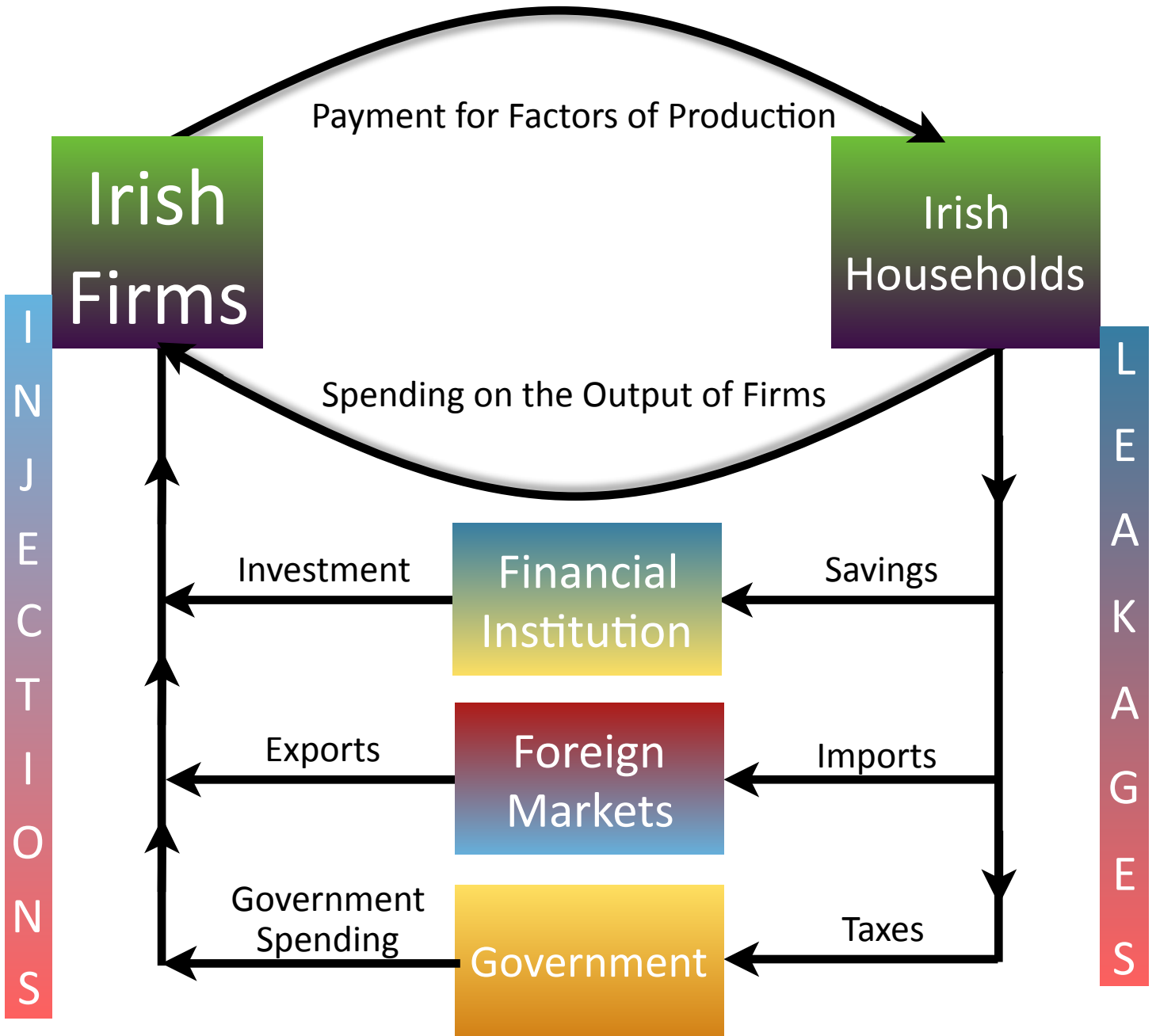
Aggregate Demand Falls if

Consumption	Investment	Gov. Spending	Exports	Imports
Income ↓	Expectations ↓	Decisions of Politicians ↓	Foreign Incomes ↓	Irish Income ↑
MPC ↓	Rate of Interest ↑		Irish Competitiveness ↓	MPM ↑
Availability of Credit ↓			Value of Euro ↑	Value of Euro ↑
Rate of Interest ↑				
Tax ↑				



- Effect***
- 1) AD ↓
 - 2) P ↓
 - 3) Y ↓
 - 4) Emp ↓
 - 5) Sav ↓
 - 6) Imp ↓

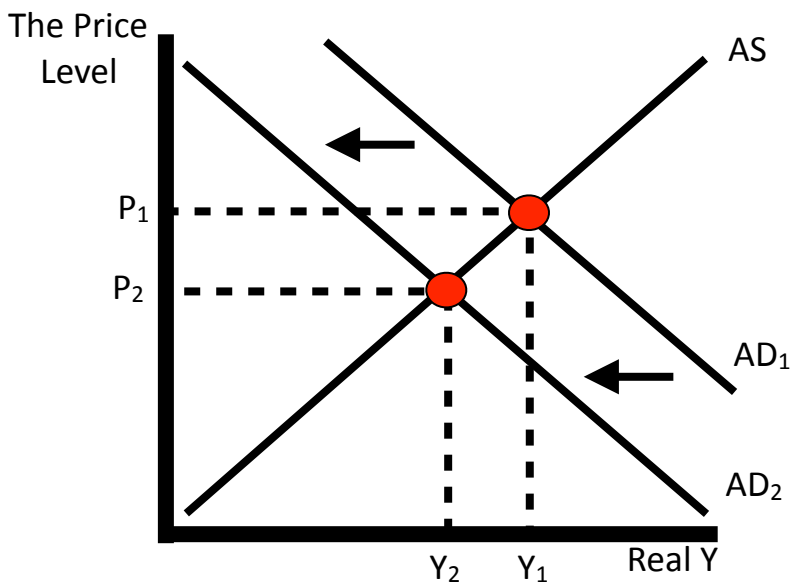
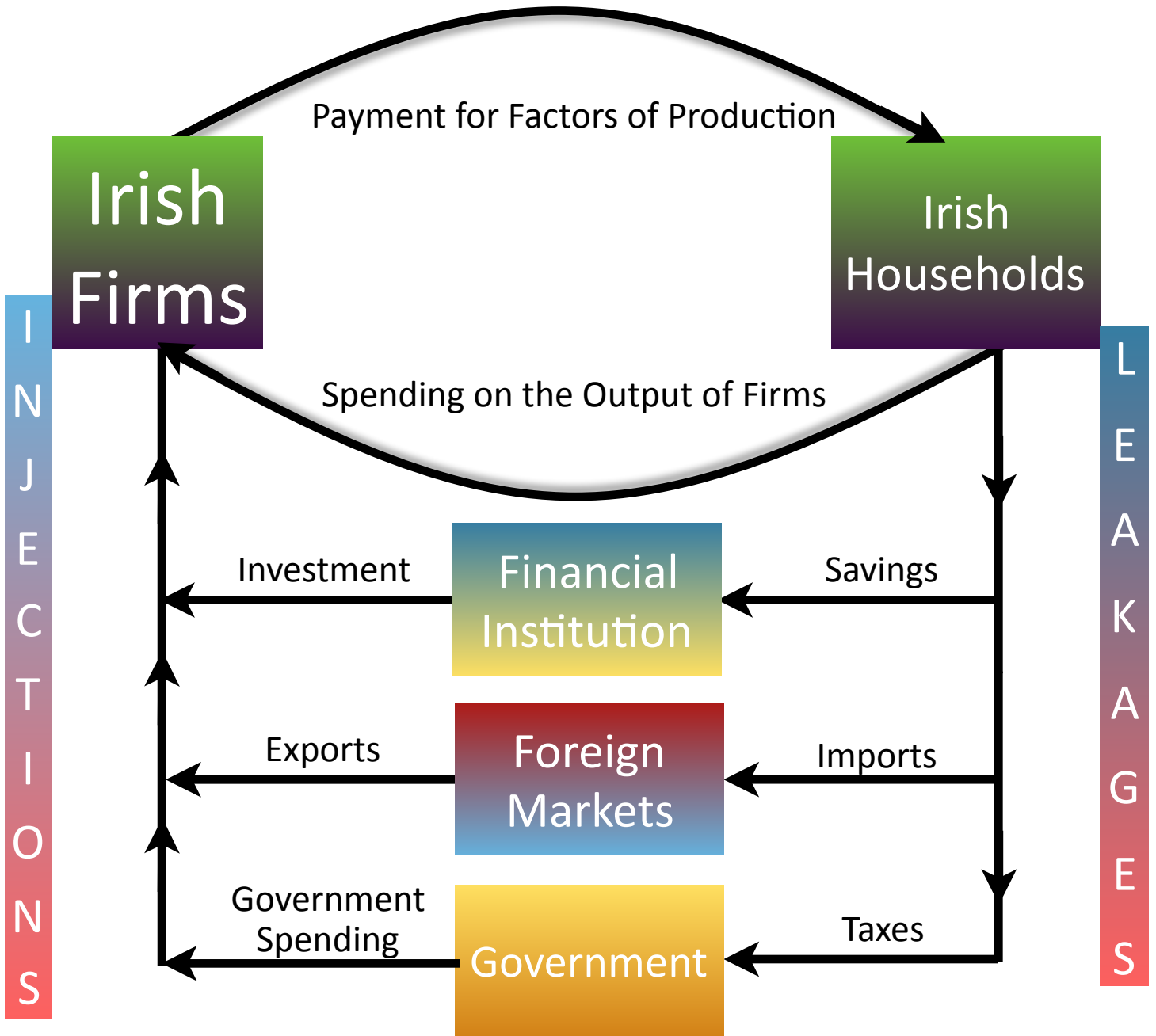
The Circular Flow of Income Diagram and the Aggregate Demand Curve



If Injections exceed Leakages

- | | |
|---------|----------|
| 1) AD ↑ | 4) Emp ↑ |
| 2) P ↑ | 5) Sav ↑ |
| 3) Y ↑ | 6) Imp ↑ |

The Circular Flow of Income Diagram and the Aggregate Demand Curve



If Leakages exceed Injections

- | | |
|---------|----------|
| 1) AD ↓ | 4) Emp ↓ |
| 2) P ↓ | 5) Sav ↓ |
| 3) Y ↓ | 6) Imp ↓ |

We have just had a quick review of the effects on the Economy of a Change in Aggregate Demand. In future newsletters we will look at how to answer questions relating to National Income.