



## Actors in the macrocircuit

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### a/Individuals

They receive a salary from the business they work for. That is: revenue =  
wage x hours ( $R = W \times h$ )

This amount is spent on

- Buying domestic goods/services (consumption C)
- Buying foreign goods/services (imports H)
- Paying the various taxes of the fiscal system (taxes T)
- Speculative transactions (investments I)

Speculative expenditure presupposes that individuals do not spend all  
their revenue (savings S)

## b/Businesses

They receive money:

- From domestic sales and foreign sales (exports E): revenue = price/unit x quantity ( $R = P \times Q$ )
- Via debt financing (bank loans) or equity financing (shares) (investment I)

These amounts are spent by the business:

- On factors of production, capital K (B2B supplies) and labour L
- For its own needs (consumption C)
- To replace depreciated and ageing capital (e.g. machines) and expand the business (investment I)

## c/The state

It receives money through the fiscal system (taxes T)

This amount is spent:

- On benefits, infrastructural works (e.g. railway), and the provision of public goods (e.g. health) (government expenditure G)
- For its own needs (e.g. office equipment) (consumption C)

What is the total that is spent in the economy?

The total of what each economic actor mainly spends as well as has a welfare impact on the economy:

- Individuals: C, as it impacts businesses – this is also applicable to businesses and the state
- Businesses: I, as it impacts C
- State: G, as it impacts both individuals and businesses

In a more complete manner

Domestic expenditure:  $C + I (= S) + G (=T)$

Foreign expenditure  $X = E - H$

Economic actor	Revenue	Expenditure
Individual	Salary	Goods/services C Savings S Taxes T
Business	Sales Investment I	Resources Goods/services C Taxes T
State	Taxes	Benefits & infrastructure G Goods/services C

Therefore:

- If there is expenditure, it is to acquire goods, services, resources, public goods
- If it is to acquire them, they must be offered/supplied/produced

⇒ there is demand for goods etc. & supply of goods etc.

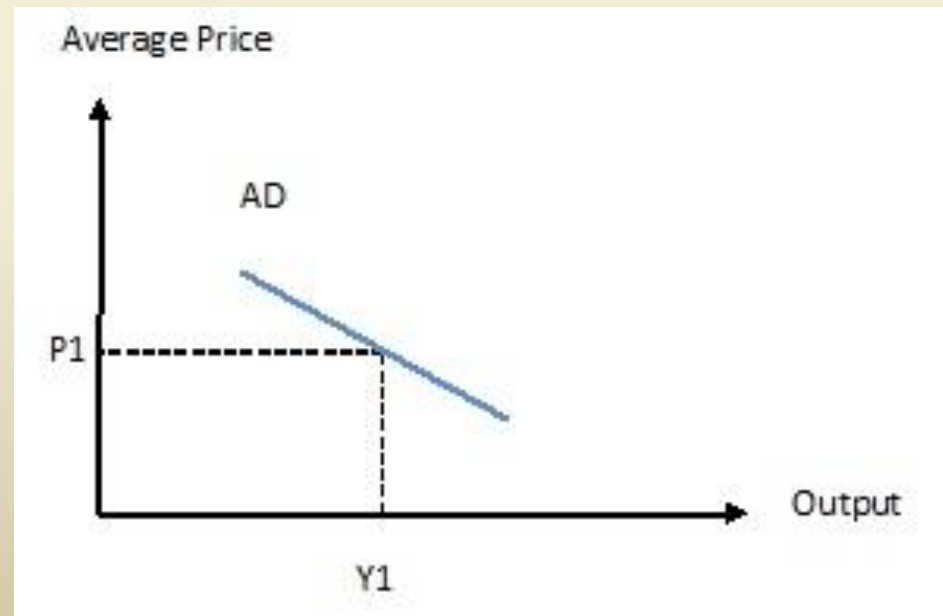
⇒ for the whole economy there is:

- aggregate demand (AD)
- aggregate supply (AS)

## AD

Aggregate demand (AD) corresponds to all demand behaviours displayed by economic actors about the goods/services (domestic & foreign). But this involves spending money to acquire the goods etc. = spending on consumption and imports (less exports), making investments, and spending on taxes to receive benefits.

Therefore  $AD = C + I + G + X$



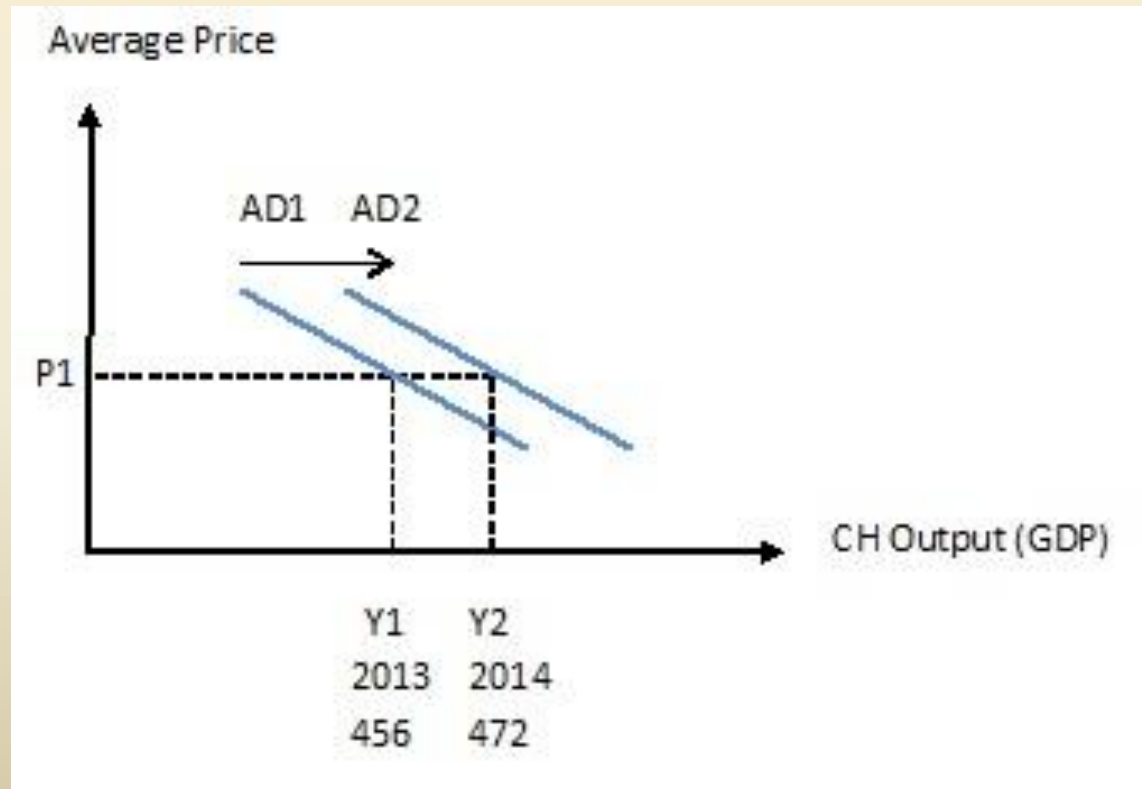


Graphically, the AD depicts various possibilities for an economy to produce goods and services i.e. to generate output i.e. income at a given level of average prices. The metrics of this income is the GDP.

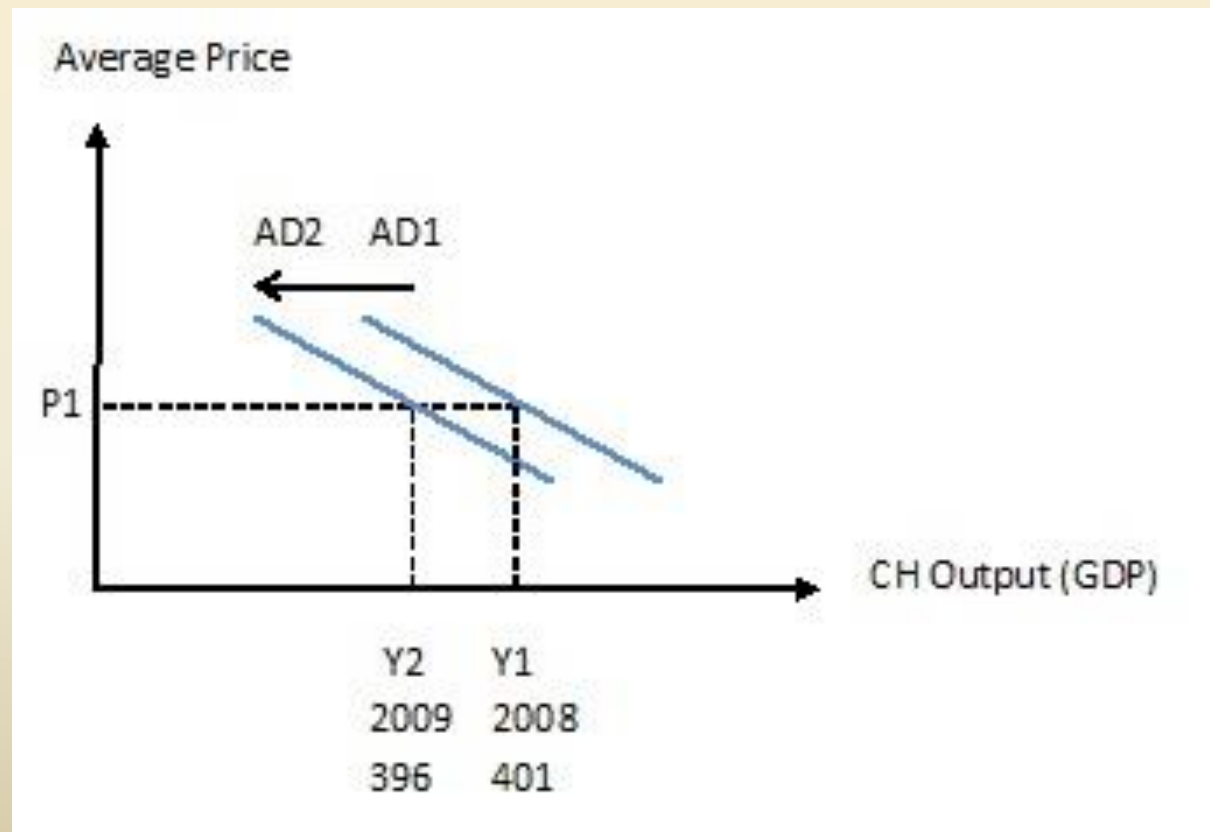
But unlike the price (P) or a give good/service that is set by the firm according to its power in the market, the average price of the economy is not set by decision: it is established statistically!

Hence the role of the consumer price index (CPI) - among others: it tracks what goods have become more expensive/cheaper so as to set an average over a given year (or other period of time if necessary).

Any change in the AD components  $C \uparrow$ ,  $I \uparrow$ ,  $G \uparrow$  shifts the AD curve to the right meaning that demand  $\uparrow$



Any change in the AD components  $C \downarrow$ ,  $I \downarrow$ ,  $G \downarrow$  shifts the AD curve to the left meaning that demand  $\downarrow$



## Factors increasing demand (AD):

- Bullish bourses shift the (AD) curve to the right – attracting investments (I).
- Improvements in technology shift the (AD) curve to the right – encouraging innovation (C, I).
- Increases in tax credits shift the (AD) curve to the right – consumption is encouraged (C); but if the tax credit is too important, G is reduced shifting the (AD) to the left.
- Increase in the money supply shifts the (AD) curve to the right – expansionary monetary policy (I).
- State investment in infrastructures shifts the (AD) curve to the right – expansionary fiscal policy (G).

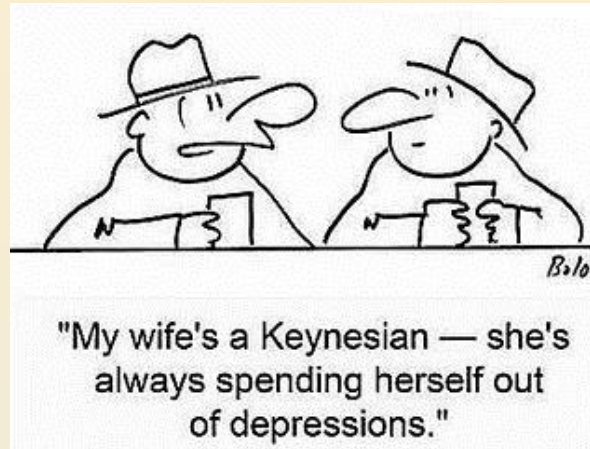
Factors *decreasing* demand (AD):

- Increased savings shifts the (AD) curve to the left because it reduces consumption (C).
- Decreases in the money supply shifts the (AD) curve to the left – tight money (I).
- Increases in taxes shift the (AD) curve to the left – consumption is discouraged (C) even though the state is seeking to finance/increase G
- Lowered purchases by the state shifts the (AD) curve to the left – lower consumption (C, G).

- Recessions in home economies reduce imports shifting the (AD) curve of the foreign economy to the left – lower exports (X).
- Appreciations of the home currency making exports more expensive than imports shifts the (AD) curve to the left – lower exports (X).



And which of the AD components is the most important? Depends on viewpoint adopted:



1. Classical view: income and spending, hence an emphasis on consumption, credit and investments through the bourses.
2. Keynesian view: state expenditure and investments.
3. Monetarist view: since there is a relationship between the value of all purchases and the money available in the economy, demand for consumer expenditure is affected by the supply of money.