

LOCKIN EDUCATION @ BUGIS



H2 ECONOMICS



AD-AS & STANDARD OF LIVING (SOL)

“The future belongs to those who believe in the beauty of their dreams” - Eleanor Roosevelt

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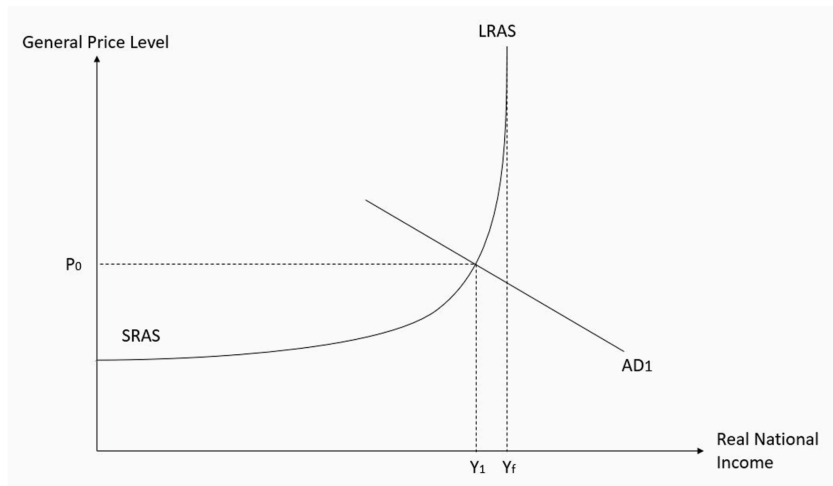
1. AD-AS

Aggregate Demand (AD) = domestic consumption expenditure + investment expenditure + government expenditure + total revenue of exports – total expenditure of imports

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

Aggregate Supply (AS) is split into short run aggregate supply (SRAS) and long run aggregate supply (LRAS)

- SRAS is affected by cost of production
- LRAS is affected by quantity and quality of factors of production, and technology (QQT).



2. Shift in AD & AS

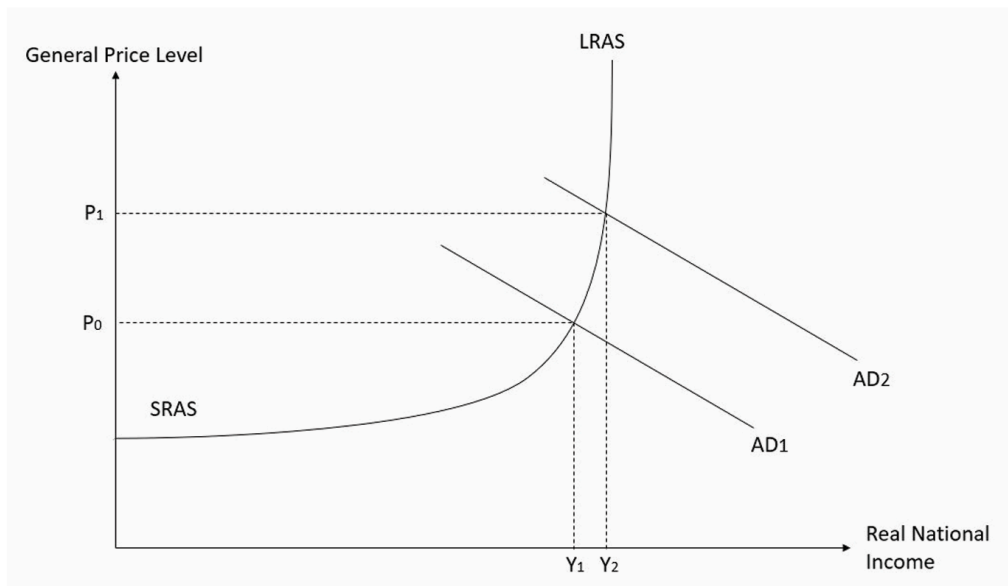
When a component of AD increases, AD shifts right causing an increase in GPL and RNY.

Key Economic Analysis:

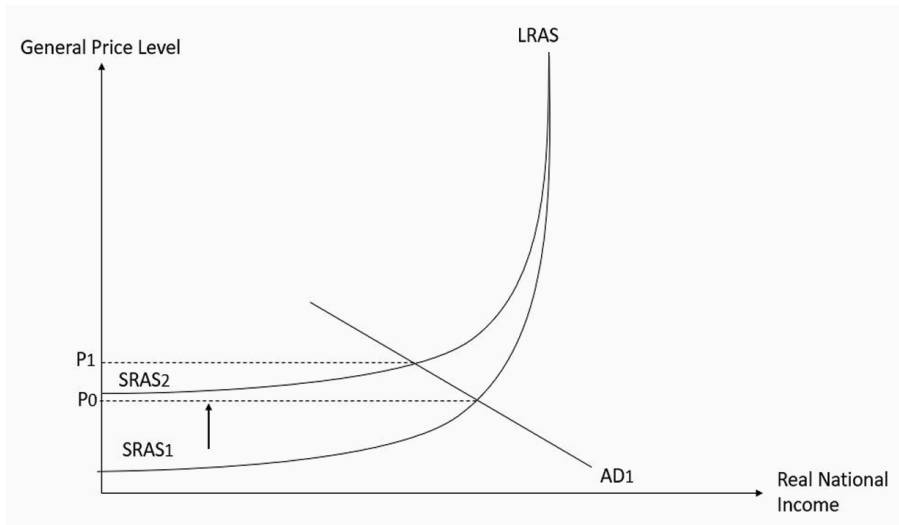
- When AD increases, there is an increase in demand for goods and services. Firms experience unplanned depletion of inventories, hence firms increase production, hire more FOPs including labour. By hiring more FOPs including labour, they have to

give out for factor payment, leading to an increase in households income, allowing purchasing power to rise, increase willingness and ability to consume goods and services, increase induced consumption, increase AD again. Firms will again increase production, hire more FOPs and give out factor payments. Hence, RNY will increase by multiple folds via the multiplier effect, allowing for actual economic growth. (Multiplier Effect)

- If the country is already operating near full employment level, the increase in AD will lead to firms competing for limited factors of production, bids up factor prices, firms will pass on the rise in cost to consumers in terms of higher prices, GPL rises, demand pull inflation occurs.



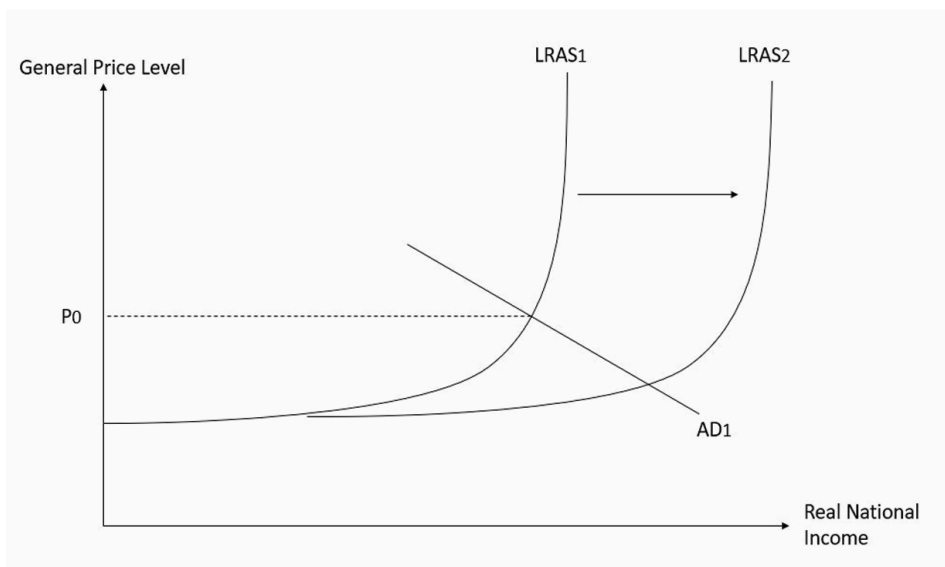
When the COP increases, there will be a fall in the willingness and ability to produce goods and services, hence SRAS decreases. (Note: When SRAS falls, GPL increases, therefore SRAS shifts up)



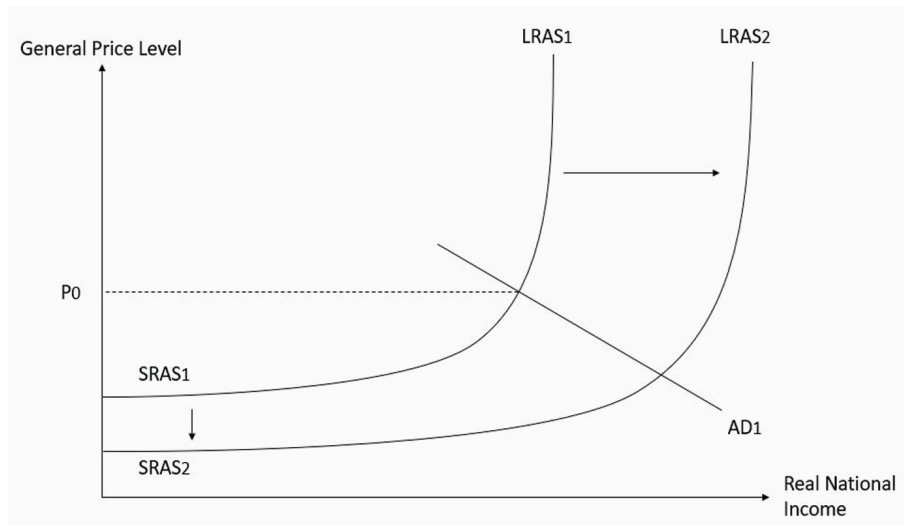
When any component of the QQT increases, it will increase the productive capacity, hence LRAS increases, indicated by a rightward shift of the LRAS curve. **Note: If LRAS increase, likely it can also cause SRAS to increase.**

Key Economic Analysis:

- If technology improves, this leads to more efficient methods of production, increased productivity and productive capacity, LRAS increasing, and potential economic growth is achieved.



If both SRAS & LRAS increase, the entire AS curve shifts to the right.



3. Standard of Living

Standard of Living (SOL) can be split into – Material SOL and Non – material SOL.

- Material SOL refers to the goods and services available for consumption. When there is an increase in income, there will be an increase in purchasing power, increase in goods and services available for consumption, material SOL increases.
- Non – material SOL measures the intangible aspects of life. Indicators include: Human Development Index (HDI), stress level, crime rates, life expectancy, literacy rate, pollution level.

4. Measuring Material SOL

- Nominal GDP: It helps to give a **rough indication** of the goods and services available for consumption. However, it **does not take into account inflation rate**. If the inflation rate is increasing faster than the nominal GDP growth rate, the goods and services available for consumption may be lower, hence material SOL may have fallen.
- Real GDP: It gives an **accurate representation** of the goods and services available

for consumption in an economy as it is adjusted for inflation. However, it **does not take into the population growth rate**. If the population growth rate increases faster than the real GDP growth rate, the average goods and services available for consumption may have fallen, material SOL may have fallen.

- Real GDP per capita: It gives an accurate representation of the **average** goods and services available. However, it does not take into account income distribution. If GINI coefficient is high (nearer to 1), it means that the income is concentrated within a small group of households. The average household may not experience an increase in goods and services available for consumption and hence average material SOL may not increase.
- The best indicator is when there is an increase in real GDP per capita with low GINI coefficient.
- Real GDP Purchasing Power Parity (PPP) Adjusted Exchange Rate: This is to account for the difference in the **cost of living among the different countries**. For example, the exchange rate between Singapore and China is 1:5. If a burger in SG cost \$5 SGD, it will be converted to 25 yuan in China. However, the same burger only cost 12.5 yuan in China due to the lower cost of living. Hence, the PPP – adjusted exchange rate will be 1 : 2.5 such that the same amount of money will be able to get the same amount of goods and services among the different countries.
- Composition of GDP: If the increase in real GDP was due to the government spending on capital goods instead of consumer goods, then the current material SOL may not have increased. However, the capital goods will help to increase the goods and services available for consumption in the future, hence future material SOL may increase instead.

5. Measuring Non-material SOL

- Life Expectancy. If LE increases, this could suggest households enjoy a better environment with less population, less stress, more access to healthcare goods and services. Hence quality of health improves, allowing them to live longer, resulting in

higher life expectancy.

- Literacy rate. If there is higher literacy rate, this could be due to having more educational institutes, greater subsidies and govt support for education or favourable shift in taste and preference towards education. Hence, greater expectation for future income due to prospect of getting higher paying jobs and less resentment towards income inequality, which will increase satisfaction of residents, hence quality of life improves, non material SOL improves.
- HDI = Average years of schooling, life expectancy, GNI per capita (PPP\$). HDI is a number between 0 to 1, where 1 represents the highest non – material SOL