

Economic Growth

Long-Run Aggregate Supply and the Production Possibilities Curve

The long-run aggregate supply (LRAS) curve is vertical at the full-employment level of output. This means that LRAS doesn't change as the price level changes. The location of the LRAS depends on the productive capacity of the economy. Developing more/better resources or improving technology will shift the LRAS curve outward.

The LRAS curve represents a point on an economy's production possibilities curve (PPC). Remember that the PPC represents the maximum output that can be produced given scarce resources. The economy grows if the PPC shifts outward because of more/better resources or technological advances. For the same reason, the LRAS curve shifts outward with more/better resources or if there are technological advances.

Aggregate output in the economy can actually be greater than LRAS in the short run. This means that resources are being used more intensively. For example, workers can work double hours in the short run. However, they can't continue to work that number of hours in the long run. Eventually, the equilibrium level of output will always return to the full-employment level. Aggregate output can only increase in the long run if the LRAS has increased.

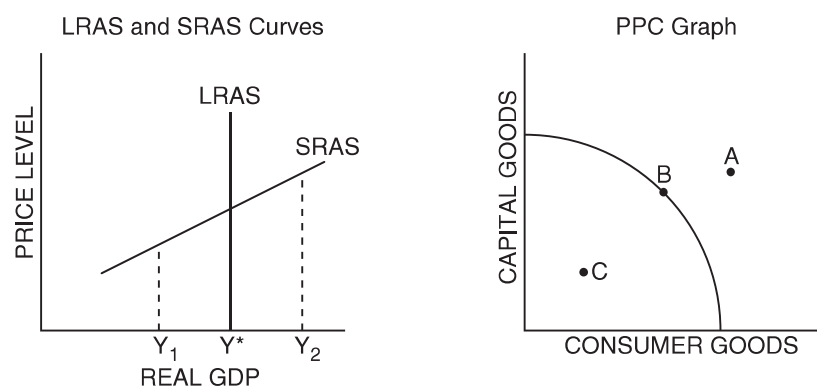
Student Alert: Make sure you don't confuse real gross domestic product (GDP) changes in the short run due to business cycles with long-run economic growth!

Use the graphs in Figure 6-1.1 to answer the questions that follow.



Figure 6-1.1

Aggregate Supply and Production Possibilities Curves



1. What does a PPC show? What are the assumptions about resources and technology in the PPC model?

2. List two things that could happen to allow the economy to produce at Point A.

3. In Figure 6-1.1, Y^* , Y_1 , and Y_2 in the aggregate supply graph correspond to which points on the PPC graph? Explain.

$Y^* \rightarrow$ Point _____

$Y_1 \rightarrow$ Point _____

$Y_2 \rightarrow$ Point _____

4. List two things that could happen to allow the economy to produce Y_2 output.

5. How can the economy produce at Y_2 in the short run? If it is producing at Y_2 in the short run, what will happen in the long run? Explain.