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TOPIC :- FACTORS RESPONSIBLE FOR CHANGES IN AGGREGATE SUPPLY

As we know that changes in input costs such as wages, oil and other input prices will cause changes in aggregate supply. Most of the factors which affect the position of the aggregate supply curve in the short-run also affect the position of the aggregate supply in the long-run. However, there are situations when there is a shift in the short-run aggregate supply curve which will have no effect on long-run aggregate supply curve. These factors are, change in costs of production, supply disturbances, investment and technological changes. Beside this, there are several factors which affect aggregate supply as explained below:-

(I) Change in Costs of Production:-

The short-run aggregate supply curve indicates the level of the output that will be produced at a given level of price. An increase in the input costs such as labour or raw-material costs, other things remaining constant, will reduce the output that the business firms are willing to supply at a given price level. Therefore the short-run aggregate curve shifts upward from right to left.

(II) Supply Shock or Supply Disturbances:-

Any increase

or decrease in current output is temporarily caused by occurrences of supply disturbances, or supply shocks. For example, favourable weather conditions will cause a bumper harvest while unfavourable conditions will cause a shortage. For economies which are predominantly agricultural like India, the effect on aggregate supply will be very significant. In such countries a natural calamity or disaster such as major floods and drought will also adversely affect aggregate supply. As these disturbances are of a temporary nature, with the return of normalcy the aggregate supply will return to the previous level.

(III) Investment spending and Technological changes:—

The other important factors which influence the aggregate supply both in the short-run and the long-run are investment and technological progress. If other things remain equal, the productivity of an economy will increase with the investments in additional capital assets. Therefore the three factors discussed above, namely costs of production, supply shocks, investment and technological changes can shift aggregate supply curve in the short-run, but will have no effect on the long-run aggregate supply curve.

(IV) Availability of Raw Materials :-

The productive potential of any economy is determined by availability of raw material which is an important factor of production. The availability and accessibility of additional raw materials input will expand the productive base of any economy. An increase in availability of raw materials initially costs low to businesses and this implies an onward shift in Aggregate supply curve. Consequently with a fall in costs of production and constant price levels the profits from any given level of production increase and therefore firms are encouraged to expand their output. Naturally the output is also on the higher side due to the availability of more raw materials.

(V) Supply of Labour :-

The outward movement of both short-run and long-run aggregate supply curve is due to the increase in supply of labour, provided other things are constant. Other things remaining constant, in the short run, an increase in labour supply will bid down the market wage and thus raise the profits for businesses from producing any given level of output. In the long run, the increase in supply of labour will enable

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an increase in the natural rate of output, which will enlarge the productive base of the economy.

(VI) Human Capital:—

It is a known fact that any economy with more highly skilled labour force has greater productivity. The nexus between the human capital and factors like education, training and health care have an important bearing on aggregate supply. Increase in training initiatives in order to raise the skill levels of the labour force will shift the short-run aggregate supply curve as well as long-run aggregate supply curve outwards.

(VII) Incentives:—

The role of incentives in improving the supply side of the economy is gaining considerable importance in the recent years. A lot of emphasis is laid on increasing incentives leading to an increase in productivity factors production. Thus, the incentives are considered as an important factor directly affecting the aggregate supply both in the short-run and in the long-run.