Aggregate demand function

In economics, aggregate demand is the total demand for final goods and services in the economy at a given time and price level. This is the demand for the gross domestic product of a country when inventory levels are static. It is often called effective demand or abbreviated as 'AD'. In a general aggregate supply-demand chart, the aggregate demand curve (AD) slopes downward (indicating that higher outputs are demanded at lower price levels).

The major analytical tool employed by J. M. Keynes in the determination of income and employment is the aggregate demand function. There are basically two approaches to the problem of aggregate demand. One is through the quantity theory of money or MV approach; and the second is the aggregate expenditure (C+I) approach.

The former treats demand as a global quantity and not as an aggregate of independently determined components. If the aggregate demand is conceived from this point of view, any possibility of the deficiency in the aggregate demand stands completely ruled out and the analysis conforms fully to Say’s law of Markets.

The alternative approach to aggregate demand function is the expenditure approach. The aggregate demand function, from this point of view means the varying amounts of income that all the entrepreneurs in that community, taken together, expect to receive by the sale of output produced by varying number of workers.

The entrepreneurical expectations of income can be understood also as the amounts which the major spending units in the economy are expected to spend at different possible levels of real income or output. The aggregate

demand schedule does not represent any particular or actual level of demand, it is simply the possible levels of demand for different categories of goods.

Aggregate supply function:

The aggregate supply function points to the fact that the existing productive capacity of the economy is utilized to a greater or lesser degree according to the expectations of the entrepreneurs. It is conceptually similar to the supply function of the individual of the individual commodities.

Just as the supply function for an individual commodity represents a series of supply prices for varying amounts of the commodity offered for sale, so does the aggregate supply function which relates a series of aggregate supply prices to the varying level of output and employment.

In other words, aggregate supply function is a schedule of the various amounts of money that the entrepreneurs in an economy must receive from the sale of output at varying levels of employment. Carefully using ideas from the theory of supply and demand, aggregate supply can help determine the extent to which increases in aggregate demand lead to increases in real output or instead to increases in prices (inflation).