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AGGREGATE DEMAND AND AGGREGATE SUPPLY MODEL

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Abstract: This article analyzes the aggregate demand (AD) and aggregate supply (AS) model as a key tool for determining economic equilibrium. The model illustrates the interrelationship between production volume, price level, and employment in the national economy. Factors influencing aggregate demand and supply, as well as their impact on state economic policy, are also examined. The findings indicate that the AD–AS model provides an important theoretical basis for analyzing macroeconomic stability.

Keywords: aggregate demand, aggregate supply, economic equilibrium, inflation, employment, macroeconomic analysis.

Introduction:

The aggregate demand and aggregate supply model is one of the most important theoretical tools in macroeconomics for analyzing economic processes. This model allows for the determination of the relationship between total production, price levels, and employment in the national economy. Aggregate demand reflects the overall demand for goods and services in the economy, representing the purchasing capacity of consumers, the government, and businesses. Aggregate supply represents the total quantity of goods and services producers are willing to supply based on available resources. The interaction of these two indicators determines economic equilibrium. Through this model, inflation, unemployment, economic growth, and the results of government policies can be analyzed. Therefore, the AD–AS model has both theoretical and practical significance in ensuring economic stability.

Aggregate Demand and Aggregate Supply in Macroeconomics:

The AD–AS model is a fundamental theoretical framework for explaining economic equilibrium in macroeconomics. It enables the analysis of production volume, price levels, employment, and inflation in an interconnected manner. Aggregate demand and supply consolidate the actions of all economic agents and help assess a country's economic potential.

Aggregate Demand (AD) represents the total demand for all goods and services in the economy. It includes the purchasing power of consumers, firms, the government, and the external sector. Demand is inversely proportional to the price level: as prices rise, demand falls; as prices decline, demand increases. As noted by economist J. M. Keynes, “Aggregate demand is the heart of economic activity, determining the level of production” [1]. This highlights that changes in aggregate demand directly affect production and employment levels.

The main components forming aggregate demand are:

Consumption expenditures (C);

Investments (I);

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Government spending (G);

Net exports (X–M).

Thus, AD = C + I + G + (X–M). This formula allows for assessing total expenditures in the national economy. For instance, the government can stimulate aggregate demand by increasing public spending or reducing interest rates.

Aggregate Supply (AS) represents the total quantity of goods and services producers are willing to supply at the national level. It depends on production factors such as labor, capital, technology, and natural resources. According to A. Smith of the classical school, "Production possibilities are based on the efficient use of resources, which determines the real capacity of the economy" [2]. This indicates that aggregate supply is closely linked to resources and technology. The AS curve is divided into short-run (SRAS) and long-run (LRAS) components. In the short run, changes in the price level affect production, while in the long run, production is determined by the economy's potential output, representing full employment.

Economic Equilibrium through the AD–AS Model:
The intersection of aggregate demand and aggregate supply represents economic equilibrium, where production volume (GDP) and the price level are aligned. Economist P. Samuelson noted, "Market economies move toward equilibrium, but this process is constantly influenced by destabilizing factors" [3]. This implies that equilibrium is not permanent—it changes under external factors such as fiscal policy, interest rates, exchange rates, or global crises.

For example, an increase in government spending shifts the AD curve to the right, raising production. Conversely, higher taxes reduce consumption, shifting AD to the left. Changes in aggregate supply are influenced by production costs and technological factors. Technological improvements increase productivity, shifting AS to the right, which promotes economic growth.

The AD–AS model is a crucial analytical tool for designing economic policy. It allows assessment of inflation, unemployment, and economic growth. When AD exceeds AS, demand-pull inflation occurs due to excess demand raising prices. Conversely, when AD is less than AS, economic stagnation and higher unemployment result. Governments base their fiscal and monetary policies on this model to maintain stability.

Nobel laureate R. Dornbusch stated, "The aggregate demand and supply model is the main framework for explaining economic stability and analyzing the consequences of policy decisions" [4]. Today, the AD–AS model is an integral part of macroeconomic analysis, applied even in contexts like digital economies, global trade, inflationary trends, and pandemics. J. Stiglitz emphasized, "Before implementing any macroeconomic policy, the results of the AD–AS model must be analyzed" [5].

Maintaining equilibrium between aggregate demand and supply is central to government economic policy. Coordinated fiscal policy (government spending and taxes) and monetary policy (money supply and interest rates) are crucial. Using the AD–AS model, policymakers can guide the economy toward stable growth.

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Conclusion:

The AD–AS model acts as a "barometer" of the economic system, explaining the complex relationships between production, prices, and employment. It enables analysis of policy effectiveness, growth potential, and inflation risks. Aggregate demand growth boosts short-term economic activity but may lead to long-term inflation. Aggregate supply, determined by resources, technology, and labor productivity, is the primary source of economic growth. When fiscal and monetary policies are based on this model, economic stability can be achieved. Therefore, properly managing the balance between aggregate demand and supply is a key factor determining the effectiveness of a country's economic policy.

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