

Long-Run Aggregate Supply (LRAS)

Long-run aggregate supply (LRAS) is the **maximum level of real output** an economy can produce when **all resources are fully and efficiently used**. It depends on the economy's **productive capacity** (the quantity and quality of factors of production).

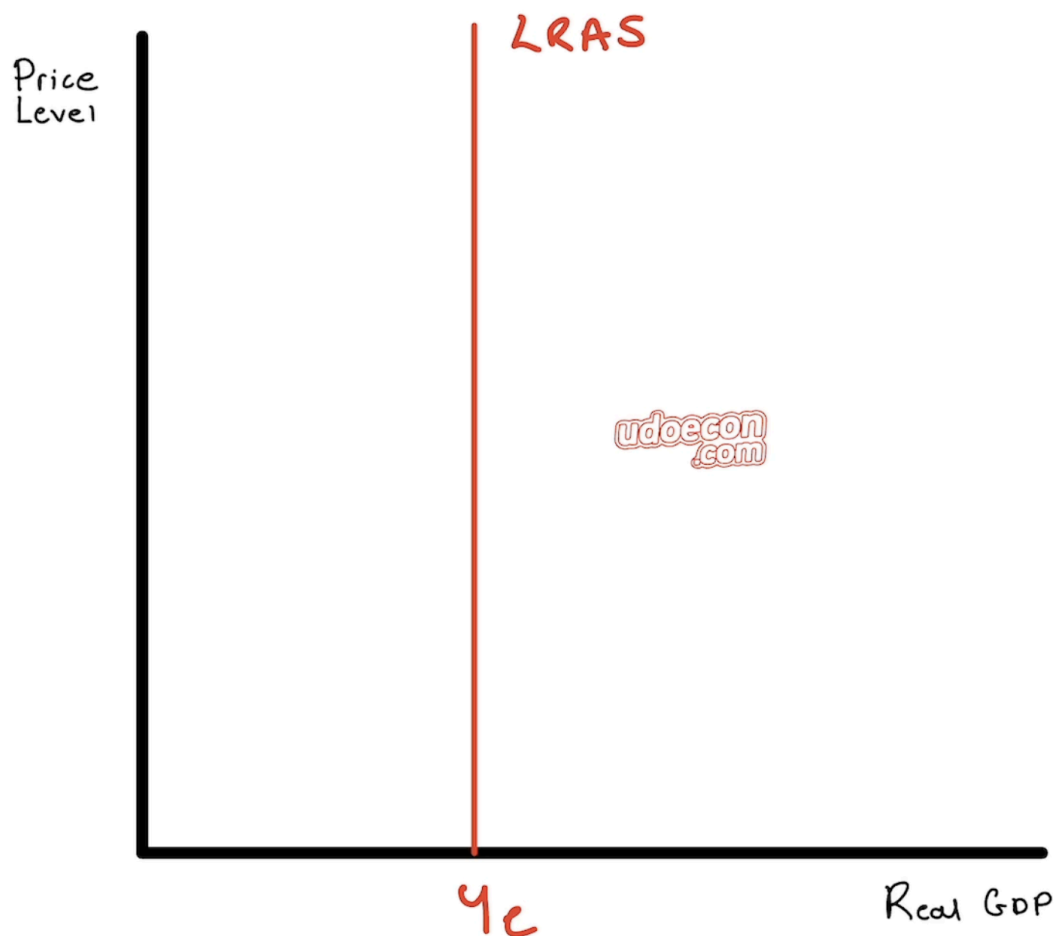
LRAS is different from SRAS because a shift in LRAS means the economy's **potential output has changed**, rather than just firms facing different short-run cost.

Two views of LRAS

Classical LRAS

The Classical view shows LRAS as **perfectly inelastic (vertical)** at the **full employment** level of output. This Neoclassical view suggests the economy tends to **return to full employment output in the long run**, even if there are short-run booms or recessions.

On a diagram, this is shown as a vertical LRAS line at output Y_e (full employment).

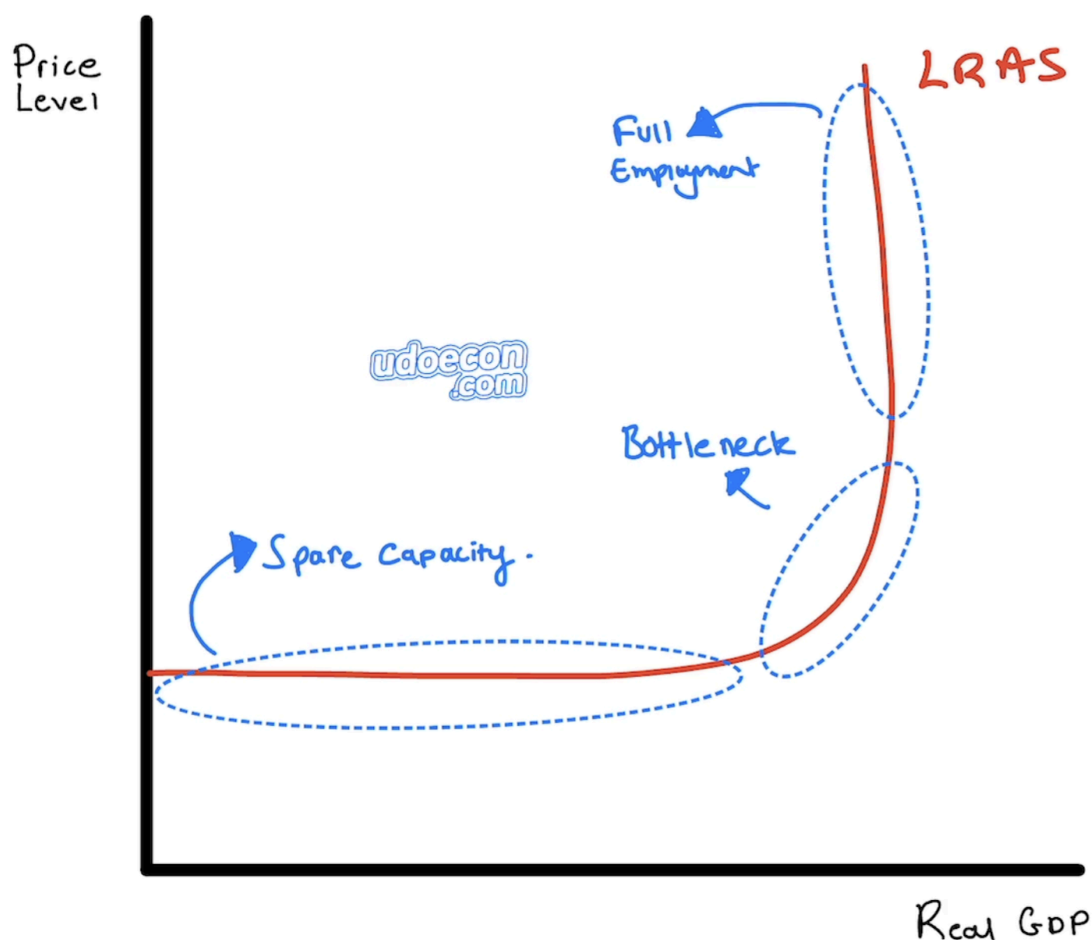


Keynesian LRAS

The Keynesian view shows LRAS as more **L-shaped**. When real GDP is low, LRAS is **flat (elastic)** because there is ample **spare capacity** (unused labour and capital), so output can rise without much upward pressure on wages and prices. This is shown as “Spare Capacity” on the diagram.

As the economy gets closer to full employment, LRAS becomes **steeper**. This is as less factors of production are available so it is harder to increase output. This is shown as “Bottleneck” on the diagram.

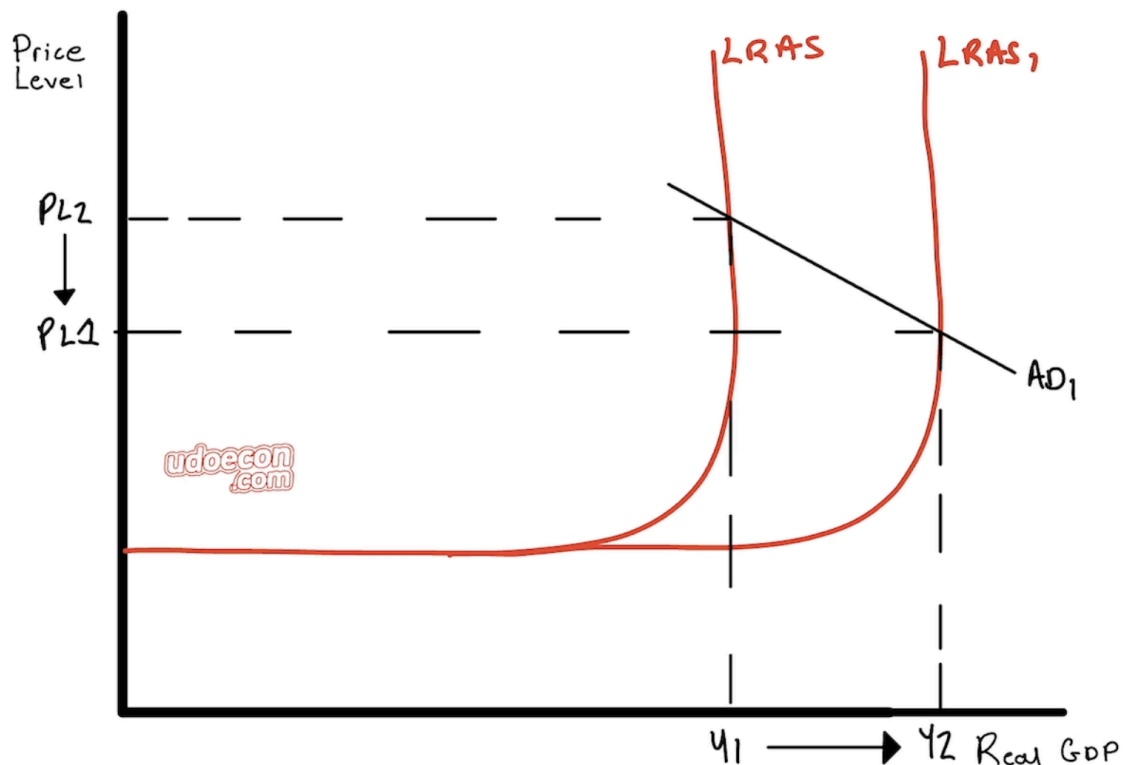
At full employment it becomes **vertical**, because all resources are being used. This is shown as “Full Employment” on the diagram.



This is why Keynesian economists argue the government may need to **step in** (e.g. **higher government spending or tax cuts**) to **boost AD** when **confidence** is low, As needed to help output and employment rise back towards full employment.

What shifts LRAS?

LRAS shifts when the economy's **productive capacity changes**. Anything that raises the **quantity or quality** of factors of production shifts LRAS **right**, meaning higher potential output.



Technology and productivity

Technological improvements raise productivity, so the economy can produce **more output with the same inputs**. Examples include the widespread adoption of computers and newer AI tools.

Education, training, and human capital

Improving education and training raises **human capital** (skills and knowledge), which increases labour productivity and potential output.

Taxes that strengthen incentives and investment

Income tax cuts can strengthen incentives to work more hours or participate in the labour force, increasing effective labour supply over time.

Corporation tax cuts can raise incentives to expand and increase retained profits, which may boost investment in capital and productivity.

Deregulation

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Reducing regulation can lower compliance costs and barriers to entry. This can increase investment and allow more firms to enter markets, raising productive capacity and shifting LRAS right.

Migration and demographic change

Positive net migration or a higher birth rate can increase the quantity of labour available, raising the productive capacity of the economy.

Competition policy

Policies that reduce monopoly power, such as preventing anti-competitive mergers, can increase competition. Greater competition pressures firms to become more efficient, lower costs, and produce more with the same inputs, shifting LRAS right.