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Assignment

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Question 1

An increase in customer's income means people have a higher purchasing power, leading to increased demand for goods. An increase in consumers' income translates into higher purchasing power; hence people spend more money acquiring more goods or upgrading the goods they already have. Goods whose demand goes up with an increase in consumers' income are known as "Normal goods." The demand for these regular goods shifts to the right as people become more likely and able to buy these goods. Despite this general outcome, there are several possible implications on demand for goods. Demand for first-class goods rises with the increase in earnings, while that for second-rate goods drops as people move to upgrade the quality of their lives due to their newly acquired economic status. Goods whose demand goes down with an increase in consumers' income are known as "substandard goods" People have a habit of wanting the best for themselves. However, low financial power makes them settle for inferior goods. Therefore, an increase in income leads to consumers' departure from these poor-quality goods. (Leibenstein. 1950)

The income-expenditure model's logic is that; a country produces as many goods as it sees sufficient for sale while the variability of the total productivity and production expenditure is intricately linked to stabilizing the economy. Consumption is an essential component of the income-expenditure model. Consumption is the rate at which people buy commodities sold in the economy; when people's income increases, their purchasing power goes up. Another critical aspect of this model is the investment expenditure, which is the money a country is willing to spend developing and researching new products. Investment expenditure is spontaneous rather than analytical and logical. The income expenditure also encompasses output, which is basically what a country is producing. The model's logic entails balancing the demand, income, and

consumption into an equilibrium that balances the country's output. A country's overall GDP demand is influenced by the levels of consumer consumption and the expenses that go into production.

An economy's potential output, also known as "natural Gross Domestic Product," is essentially an analysis of the resource at the country's disposal and how effectively it can utilize those resources to produce goods and services. In defining the potential economic output, resources are viewed as both natural and human. Essentially, an economy with many skilled workers compared to unskilled ones is likely to have a higher economic output. Economists have isolated common misinformation involved in defining this concept. Contrary to popular belief, the potential economic output is not what a country can produce if all workers were absorbed into the workforce and utilized fully. The potential output is critical in making financial predictions, policy formulation, and budget allocation in a financial year. The potential economic output is influenced by the affordability and availability of resources and how the country can effectively utilize these resources. Potential output largely depends on the workforce's productivity; that is, how many eligible workers are willing to work and their productivity.

(DeMasi. 1997)

References

DeMasi, P. (1997). IMF estimates of potential output: theory and practice.

Leibenstein, H. (1950). Bandwagon, snob, and Veblen effects in the theory of consumers' demand. *The quarterly journal of economics*, 64(2), 183-207.

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