

PART II

BEHAVIOURAL AND TECHNOLOGICAL FUNCTIONS

- | | |
|--|---|
| 5. Consumption Function | 8. Money Demand and Supply Functions |
| 6. Investment Function | 9. Production Function, Factor Market, and Aggregate Supply Function |
| 7. Government, Foreign Trade, and Foreign Exchange Rate Functions | |

Economic growth, unemployment and inflation are the three major concerns of any economy. The levels of the first two are governed by the real national income and that of the last by the general price level. The real national income and the general price, in turn, are determined by the interactions of the aggregate demand and aggregate supply functions, just as the quantity and price of an individual commodity are determined by the interactions of the demand for and supply of that commodity. Behind the aggregate demand (AD) are its components, which are private consumption, investment, government expenditure and net exports. Each of these components is governed by different sets of variables and, thus, there is a need to understand the functions for all these components. Behind the aggregate supply (AS) are the production function, and the demand for and supply of the various factors of production (inputs). This section deals with all these behavioural/technological functions.

Before proceeding to dwell on various functions, it is imperative to note that all macroeconomic functions are basically derived from their corresponding microeconomic functions, which are founded on the postulate of the optimum behaviour of individual decision makers. Thereby, an individual households' decision on the division of its disposable income into consumption and saving, and summation of that over all households yields the macroeconomic consumption function. Similarly, an individual firm's decision on the amount of its investment and the summation of that over all firms gives the macroeconomic investment function. Likewise, an individual firm's demand for labour and the summation of that over firms provides the macroeconomic demand for labour function; and the individual worker's supply of labour function [derived through the maximisation of his/her utility (satisfaction) from leisure and work, subject to the budget (time) constraint] summed over workers gives the macroeconomics labour supply function. This is what is referred to as the microeconomic foundation of macroeconomics. While the production function is a technological function—as it is the technology that determines the required inputs for a given output—all other functions are behavioural—as they are hypothesised