Operation Of An Economy (Firms & Households)

Vinoth Radhakrishnan

INTRODUCTION

OPERATION OF AN ECONOMY

An economy depends on the operational performance of the following two interdependent agents.

1. Firms
2. Households

By establishing the relationship between firms and households of an economy, we will be able to do following activities.

1. To create an effective economic policy.
2. To measure the effectiveness of the economic policy.
3. To control the economic fluctuations through economic policies.

FIRMS

A Firm in an economy is started by the **investors** to make profit by buying the inputs from the **suppliers** and converting the inputs in to outputs for their **customers** using **employees and operation process.**

Income of Firms

1. **Firms price**
   Firms in an economy sell their goods and services to customers (households and firms) at market price called **Firms price**.

   Income of the firm is quantity sold multiplied by the respective price for each good and service of the firm.

   Income of firms = quantity sold x Firms price

Expense of Firms

1. **Suppliers price**
   Firms in an economy buy goods and services from other firms in the market and the price paid is called as **suppliers price**

2. **Investors profit**
   Firms in an economy are started by the investors to buy the inputs from the suppliers and convert the inputs in to outputs for their customers using employees and operation process and the profit earned by the firm is called as **Investors profit**.

3. **Employee salaries or wages**
   Firms in an economy employ households to convert the inputs bought from the suppliers in to outputs for the customers of the firm and the price paid is called as **Employee salaries or wages.**

4. **other operating expenses**
   Other Operating expenses of the firm will help the firm to convert the inputs bought from the suppliers in to outputs for their customers and the price paid is called as **Other operating expenses.**

Expense of firms = supplier's price + investors profit + employees salary or wages + other operating expenses

HOUSEHOLDS

household in an economy create **Income** through the **supply of Labour (**To earn Wages or Salaries), **supply of Land** (To earn Rent) and **supply of Capital** (To earn Interest or Return on Investment) and spend the part of the income to **consume** the goods and services of the firms and **save** the remaining part of the income for future consumption.

Income of households are as follows

1. **Wages or salaries**
   Households in an economy earns **wages or salaries** by providing labour services to the firms.
2. **Rent**
   Households in an economy earns **rent** by providing land, buildings and equipment's to firms and households.
3. **Interest**
   Households in an economy earns **interest** for providing debt to firms and households.
4. **Return on investment**
   Households in an economy earns **return on investment** by investing in Firms equity and by selling assets to Firms.

Income of Households = wages or salaries + Rent + Interest + Return on investment

Expense of households are as follows

1. **Consumption expenditure**
   Households in the economy will spend the part of the income to consume the goods and services of the firms

2. **Savings for future consumption expenditure**
   Households in the economy will save the remaining part of the income to consume the goods and services of the firms in future.

   Expense of Households = consumption expenditure + savings for future consumption expenditure

RELATIONSHIP BETWEEN FIRMS AND HOUSEHOLDS IN AN ECONOMY

To determine the relationship between the firms and households in the operation of an economy, we must study in detail about the relationship between income and expenses of both firms and households

There is a relationship between the income and expenses of both households and firms in an economy and the relationships are as follows.

1. Firm's expense is equal to Households income
2. Firm's income is equal to households Income.

Relationship between Firm's expense and Households income

Expenses of the firms is always equal to the incomes of the households in an economy.

Firm's expenses = household's income

Firm's expenses

Variables of the firm's expenses are as follows.

1. Suppliers price
2. Investors profit
3. Employee's salaries or wages
4. Other Operating expenses

Firm's expenses = suppliers price + investors profit + employees salary or wages + other operating expenses

Households Income

Variables of the household's income are as follows.

1. Wages or salaries
2. Rent
3. Interest
4. return on investment

household's Income = wages or salaries + rent + interest + return on investment + savings for future expenditure

There is a relationship between the variables of the Firm's expense and variables of the Households income and they are as follows.

1. Relationship between Firms - Employee salaries or wages and Households – wages or salaries.
2. Relationship between Firms - Investors profit and Households – return of investment and interest.
3. Relationship between Firms - Other Operating expenses and Households – Rent and Return on Investment.
4. Relationship between Fim's - Suppliers price and household's – wages or salaries, interest, rent & return on investment.

Relationship between Firms - Employee salaries or wages and Households – wages or salaries

Employees of the firm works for the investors to convert the inputs bought from the suppliers in to outputs for their customers. Households provides labour services to firms to earn salaries or wages.

There is a positive relationship between the employee's salaries or wages of the firms and wages or salaries of the households.

Changes in Firms expense - employee salaries or wages

Increase in employee's salaries or wages

- Increase in employee's salaries or wages of the firms will increase the wages or salaries of the households.

Decrease in employee's salaries or wages

- Decrease in employee's salaries or wages of the firms will decrease the wages or salaries of the households.

Changes in Households Income – wages or salaries

Increase in wages or salaries

- Increase in wages or salaries of the households will increase the employee salaries or wages of the firm.

decrease in wages or salaries

- Decrease in wages or salaries of the households will decrease the employee salaries or wages of the firm.

Relationship between Firms - Investors profit and Households – return of investment and interest

Investors in an economy expect the firm to make profit. Both households and firms invest in the firms to earn return on investment from firm's equity and interest from firm's debt.

Return on Investment from Firm's equity

Equity is the part of the capital structure of the firms. Dividend is paid out of the profits of the firm to the investors of the firm as a return for their investment in the firm.

There is a positive relationship between the Investors profit of the firms and return on investment of the households.

Changes in Firms Expense – Investors profit

Increase in investors profit

- Increase in investors profit of the firms will increase return on investment of the households.

Decrease in investors profit

- decrease in investors profit of the firms will decrease return on investment of the households.

Changes in household's Income – Return on Investment

Increase in return on investment

- increase in return on investment of households will increase their investments in the firm and it will increase the investors profit of the firms.

Decrease in return on investment

- Decrease in return on investment of households will decrease their investments in the firm and it will decrease the investors profit of the firms.

Interest from firm's debt

Debt is another part of the capital structure of the firms. Interest is paid out of the profits of the firm to the debtors of the firm.

There is a positive relationship between the Investors profit of the firms and Interest of the households.

Changes in Firm's Expense – Investors profit

Increase in investors profit

- Increase in investors profit of the firms will increase the interest of the households.

Decrease in investors profit

- decrease in investors profit of the firms will decrease interest of the households.

Changes in Household's Income – Interest

Increase in Interest

- Increase in Interest income of households will increase their investments in the firm, and it will increase the investors profit of the firms.

Decrease in Interest

- Decrease in Interest income of households will decrease their investments in the firm, and it will decrease the investors profit of the firms.

Relationship between Firms - Other Operating expenses and Households – Rent and Return on Investment

Other Operating expenses of the firm will help the firm to convert the inputs bought from the suppliers in to outputs for their customers. Other operating expenses of the firms are rent and depreciation.

Rent

Firms will pay rent to households or firms for the use of land, buildings and equipment's.

There is a positive relationship between the other operating expenses (rent) of the firms and the rent of the households.

Changes in Firm's Expense – Other Operating Expenses (rent)

Increase in other operating expenses (rent)

- Increase in other operating expenses(rent) of the firms will increase the rent of the households.

Decrease in other operating expenses(rent)

- Decrease in other operating expenses(rent) of the firms will decrease the rent of households.

Changes in Household's Income – Rent

Increase in rent

- Increase in rent of the households will increase the other operating expenses(rent) of the firms.

Decrease in rent

- Decrease in rent of the households will decrease the other operating expenses(rent) of the firms.

Depreciation

Households or Firms will sell the assets like land, buildings and equipment's to firms to earn return on their investment.

Firms will depreciate the assets like buildings and equipment's bought from the households or firms

There is a positive relationship between the other operating expenses (depreciation) of the firms and return on investment of the households.

Changes in Firms Expense – Other Operating Expenses (depreciation)

Increase in other operating expenses(depreciation)

- Increase in other operating expenses(depreciation) of the firms will increase the return on investments of the households.

Decrease in other operating expenses(depreciation)

- Decrease in other operating expenses(depreciation) of the firms will decrease the return on investments of households.

Changes in Household's Income – Return on investment

Increase in return on investment

- Increase in Return on investments of the households will increase the other operating expenses(depreciation) of the firms.

decrease in return on investment

- decrease in Return on investments of the households will decrease the other operating expenses(depreciation) of the firms.

Relationship between Fim's - Suppliers price and household's – wages or salaries, interest, rent & return on investment

Firms will buy goods and services from the suppliers in the market to convert the inputs in to outputs for their customers by using employees. Firms will buy goods and services from another firm in the market.

Primary relationship

There is a primary positive relationship between the **suppliers price** of the buying firm and the expenses **(employee salary or wages, investors profit, other operating expenses and suppliers price)** of the selling firm.

Changes in selling Firm's Expense – employee salary or wages, investors profit, other operating expense and suppliers

Increase in Selling Firm's Expense

- Increase in any one or more of the selling firms expenses will increase the suppliers price of the buying firm.

Decrease in Selling Firm's Expense

- decrease in any one or more of the selling firms expenses will decrease the suppliers price of the buying firm.

Changes in buying Firm's -suppliers price

Increase in suppliers price

- increase in suppliers price of the buying firms will increase one or more expenses of the selling firms.

Decrease in suppliers price

- decrease in suppliers price of the buying firms will decrease one or more expenses of the selling firms.

Secondary relationship

There is a secondary positive relationship between the selling Firm's Expenses **(employee salary or wages, investors profit, other operating expenses and suppliers price)** and household's income **(wages or salaries, rent, interest and return on investment)** following variables.

1. Secondary positive relationship between the Selling Firm's **employee salary or wages** and Household's **wages or salaries.**
2. Secondary positive relationship between the Selling Firm's **Investors profit** and Household's **Return on Investment and interest.**

3. Secondary positive relationship between the Selling Firm's **other operating expenses** and Household's **Rent and Return on investment**.
4. Primary positive relationship between the **suppliers price** of the buying firm and the expenses **(employee salary or wages, investors profit, other operating expenses and suppliers price)** of the selling firm.

Changes in selling Firm's Expenses - employee salary or wages, investors profit, other operating expenses and suppliers price

Increase in selling Firm's Expenses

- Increase in employee's salaries or wages of the firms will increase the wages or salaries of the households.
- Increase in investors profit of the firms will increase return on investment of the households.
- Increase in investors profit of the firms will increase the interest of the households.
- Increase in other operating expenses(rent) of the firms will increase the rent of the households.
- Increase in other operating expenses(depreciation) of the firms will increase the return on investments of the households.
- Increase in buying firm supplier price will increase the expenses of the selling firms in the primary relationship and in secondary relationship increase in selling firms expenses will increase the respective household incomes.

decrease in selling Firm's Expenses

- Decrease in employee's salaries or wages of the firms will decrease the wages or salaries of the households.
- decrease in investors profit of the firms will decrease return on investment of the households.
- decrease in investors profit of the firms will decrease interest of the households.
- Decrease in other operating expenses(rent) of the firms will decrease the rent of households.
- Decrease in other operating expenses(depreciation) of the firms will decrease the return on investments of households.
- Decrease in buying firm supplier price will decrease the expenses of the selling firms in the primary relationship and in secondary relationship decrease in selling firms expenses will decrease the respective household incomes.

Changes in Households Incomes – wages or salaries, rent, interest and return on investment

Increase in household's incomes

- Increase in wages or salaries of the households will increase the employee salaries or wages of the firm.
- increase in return on investment of households will increase their investments in the firm and it will increase the investors profit of the firms.
- Increase in Interest income of households will increase their investments in the firm, and it will increase the investors profit of the firms.
- Increase in rent of the households will increase the other operating expenses(rent) of the firms.
- Increase in Return on investments of the households will increase the other operating expenses(depreciation) of the firms.

- Increase in households incomes will increase the respective selling firms expenses in the secondary relationship and increase in the selling firms expenses will increase the supplier price of the buying firm in the primary relationship.

Decrease in household's incomes

- Decrease in wages or salaries of the households will decrease the employee salaries or wages of the firm.
- Decrease in return on investment of households will decrease their investments in the firm and it will decrease the investors profit of the firms.
- Decrease in Interest income of households will decrease their investments in the firm, and it will decrease the investors profit of the firms.
- Decrease in rent of the households will decrease the other operating expenses(rent) of the firms.
- decrease in Return on investments of the households will decrease the other operating expenses(depreciation) of the firms.
- decrease in households incomes will decrease the respective selling firms expenses in the secondary relationship and decrease in the selling firms expenses will decrease the supplier price of the buying firm in the primary relationship.

Relationship between Firm's Income and Households Expense

Incomes of the firms is always equal to the Expenses of the households in an economy.

Firm's Income = household's Expense

Firm's Income

Variables of the firm's Income are as follows.

1. Firm's price

Firm's Income = Quantity sold x Firms price

Household's Expense

Variables of the household's expense are as follows.

1. Consumption expenditure
2. Saving for future consumption expenditure

Household's Expense = consumption expenditure + savings for future consumption expenditure

There is a relationship between the variables of the Firm's Income and variables of the Households expenses and they are as follows.

1. Relationship between Firm's - firm's price and household's - consumption expenditure.
2. Relationship between Firm's - firm's price and households - savings for future consumption expenditure.

Relationship between Firm's - firm's price and household's - consumption expenditure

Firms in an economy sell their goods and services to households at the market price. Households in an economy will buy goods and services from the firms at the market prices.

There is a positive relationship between the firm's price of the Firms and the consumption expenditure of the households.

Changes in the Firms Income- Firm's price

Increase in Firm's price

- Increase in the firm's price of the firms will increase the consumption expenditure of the households.

Decrease in Firm's price

- Decrease in the firm's price of the firms will decrease the consumption expenditure of the households.

Changes in the Households Expense – Consumption Expenditure

Increase in Consumption Expenditure

- Increase in consumption expenditure of the households will increase the firm's price of the firms.

Decrease in Consumption Expenditure

- decrease in consumption expenditure of the households will decrease the firm's price of the firms.

Relationship between Firm's - firm's price and households - savings for future consumption expenditure.

Firms in an economy sell their goods and services to households at the market price. Households in an economy will buy goods and services from the firms at the market prices and save the remaining part of their household's income for future consumption of the goods and services of the firms at the market price.

There is a Negative relationship between the firm's price of the Firms and the savings for future consumption expenditure of the households.

Changes in the Firms Income- Firm's price

Increase in Firm's price

- Increase in the firm's price of the firms will decrease the savings for future consumption expenditure of the households.

Decrease in Firm's price

- Decrease in the firm's price of the firms will increase the savings for future consumption expenditure of the households.

Changes in the Households Expense – savings for future Consumption Expenditure

Increase in savings for future Consumption Expenditure

- Increase in savings for future consumption expenditure of the households will decrease the firm's price of the firms.

Decrease in savings for future Consumption Expenditure

- decrease in savings for future consumption expenditure of the households will increase the firm's price of the firms.

CREATE, MEASURE AND CONTROL OF ECONOMIC POLICY

Effectiveness of the economic policy in the economy should analysed at the following stages of the economic policy.

1. Creation of an economic policy
2. Measurement of an economic policy
3. Control of an economic policy

Effectiveness of the economic policies in an economy can be analysed by the following models.

1. Production Model
   Production model is used to measure the impact on the economy due to the economic policies changes in the product market.

   The fundamental condition is that Firms Income equals Firms Expense.

   Firms Incomes = Firms Expenses

2. Labour model
   Labour model is used to measure the impact on the economy due to the economic policies changes in the labour market.

   The fundamental condition is that Households Income equals Households Expense.

   households Income = Households Expense

3. Aggregate model
   Aggregate model is used to measure the impact on the economy due to the economic policy changes in the product and labour market.
   The fundamental condition is that expenses of the firms and households create demand for goods and services and incomes of firms and households create supply of goods and services.

   Demand for money (Expenses of firms and households) = supply of money (Incomes of firms and households)

PRODUCTION MODEL

Production model is used to measure the impact on the economy due to the economic policies changes in the product market.

The fundamental condition is that Firms Income equals Firms Expense.

Firms Incomes = Firms Expenses

Production model is used to measure the impact of the economic policies in an economy by analysing the impact of the changes in one variable of the firms Income and Expense to the remaining variables of the firms Income and Expense.

Firms Income

- Frims price

Firms Expense

- Employee salaries or wages
- Investors profit
- Suppliers price
- Other Operating expenses

Firm's Price = suppliers price + investors profit + employees salary or wages + other operating expenses

Changes in the Firms Income – Firm price

Firms price in the product market will incur following changes.

- Increase in Firms price
- Decrease in Firms price

Increase in firm's price

Increase in the firm's price will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – Increase in Firms price

Increase in the firm's price of the firm's income will increase one or more expenses of the following firm's expenses.

- Employees salary or wages
- Investors profit
- Other operating expenses
- Suppliers price

Firms Incomes = Firms Expenses

Labour market – Increase in Firms price

Increase in the firm's price of the firm's income will increase one or more expenses of the firm's expenses and increased firm's expenses will increase their respective Households income.

- Increase in employee salaries or wages of the firm's expense will increase the wages or salaries of the household's income.
- Increase in investors profit of the firm's expense will increase the return on investment and interest of the household's income.
- Increase in other operating expenses of the firm's expense will increase the rent and return on investment of the household's income.
- Increase in supplier's price of the firm's expense will increase one or more of the household's incomes like wages or salaries, rent, interest and return on investment.

Increase in any one or more of the wages or salaries, rent, interest and return on investment of the household incomes will increase the expenses of the households in the following manner.

- Consumption expenditure
  Increase in the firm's price of the firms will increase the consumption expenditure of the households.
- Savings for future consumption expenditure
  Increase in the firm's price of the firms will decrease the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – Increase in Firms price

Increase in the firm's price of the firm's income will increase the following

- Increase the firm's expense
- Increase the household's income
- Increase the household's expense

supply of goods and services (Incomes of firms and households)

changes (Increase in Firms price) in Firm's income and Increase in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Increase of firm's expense and constant households' expense will partially increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Decrease in Firms price

Decrease in the firm's price will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – decrease in Firms price

Decrease in the firm's price of the firm's income will decrease one or more expenses of the following firm's expenses.

- Employees salary or wages
- Investors profit
- Other operating expenses
- Suppliers price

Firms Incomes = Firms Expenses

Labour market – Decrease in Firms price

Decrease in the firm's price of the firm's income will decrease one or more expenses of the firm's expenses and decreased firm's expenses will decrease their respective Households income.

- Decrease in employee salaries or wages of the firm's expense will decrease the wages or salaries of the household's income.
- Decrease in investors profit of the firm's expense will decrease the return on investment and interest of the household's income.
- Decrease in other operating expenses of the firm's expense will decrease the rent and return on investment of the household's income.
- Decrease in supplier's price of the firm's expense will decrease one or more of the household's incomes like wages or salaries, rent, interest and return on investment.

Decrease in any one or more of the wages or salaries, rent, interest and return on investment of the household incomes will decrease the expenses of the households in the following manner.

- Consumption expenditure
  Decrease in the firm's price of the firms will decrease the consumption expenditure of the households.
- Savings for future consumption expenditure
  Decrease in the firm's price of the firms will increase the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – Decrease in Firms price

Decrease in the firm's price of the firm's income will decrease the following

- Decrease the firm's expense
- Decrease the household's income
- Decrease in household's expense

supply of goods and services (Incomes of firms and households)

changes (Decrease in Firms price) in firm's income and decrease in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

decrease in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Firms Expense – Employee salaries or wages

Employee salaries or wages in the product market will incur following changes.

- Increase in employee salaries or wages
- Decrease in employee salaries or wages

Increase in Employee salaries or wages

Increase in the employee salaries or wages will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – increase in employee salaries or wages

Increase in the employee salaries or wages of the firm's expense will increase the firm's price of the firm's income.

Firms Incomes = Firms Expenses

Labour market – increase in employee salaries or wages

Increase in employee salaries or wages of the firm's expense will increase the wages or salaries of the household's income.

Increase in wages or salaries of the household incomes will increase the expenses of the households in the following manner.

- Consumption expenditure
  Increase in the firm's price of the firms will increase the consumption expenditure of the households.
- Savings for future consumption expenditure
  Increase in the firm's price of the firms will decrease the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – increase in employee salaries or wages

Increase in the employee salaries or wages of the firm's expenses will increase the following

- Increase the firm's income
- increase the household's income
- Increase the household's expense

supply of goods and services (Incomes of firms and households)

Increase in Firm's income and increase in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Changes (increase in employee salaries or wages) in firm's expense and increase in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Decrease in Employee salaries or wages

decrease in the employee salaries or wages will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – decrease in employee salaries or wages

Decrease in the employee salaries or wages of the firm's expense will decrease the firm's price of the firm's income.

Firms Incomes = Firms Expenses

Labour market – decrease in employee salaries or wages

decrease in employee salaries or wages of the firm's expense will decrease the wages or salaries of the household's income.

decrease in wages or salaries of the household incomes will decrease the expenses of the households.

- Consumption expenditure
  Decrease in the firm's price of the firms will decrease the consumption expenditure of the households.
- Savings for future consumption expenditure
  Decrease in the firm's price of the firms will increase the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – decrease in employee salaries or wages

decrease in the employee salaries or wages of the firm's expenses will decrease the following

- Decrease the firm's income
- Decrease the household's income
- Decrease the household's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and decrease in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Changes (decrease in employee salaries or wages) in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Firms Expense – Investors profit

Investors profit in the product market will incur following changes.

- Increase in investors profit
- Decrease in investors profit

Increase in Investors profit

Increase in the investors profit will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – increase in investors profit

Increase in the investors profit of the firm's expense will increase the firm's price of the firm's income.

Firms Incomes = Firms Expenses

Labour market – increase in investors profit

Increase in investors profit of the firm's expense will increase the return on investment and interest of the household's income.

Increase in return on investment and interest of the household incomes will increase the expenses of the households in the following manner.

- Consumption expenditure
  Increase in the firm's price of the firms will increase the consumption expenditure of the households.
- Savings for future consumption expenditure
  Increase in the firm's price of the firms will decrease the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – increase in investors profit

Increase in the investors profit of the firm's expenses will increase the following

- Increase the firm's income
- increase the household's income
- Increase the household's expense

supply of goods and services (Incomes of firms and households)

Increase in Firm's income and increase in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Changes (increase in investors profit) in firm's expense and increase in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Decrease in Investors profit

Decrease in the investors profit will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – Decrease in investors profit

Decrease in the investors profit of the firm's expense will decrease the firm's price of the firm's income.

Firms Incomes = Firms Expenses

Labour market – decrease in investors profit

Decrease in investors profit of the firm's expense will decrease the return on investment and interest of the household's income.

decrease in return on investment and interest of the household incomes will decrease the expenses of the households in the following manner.

- Consumption expenditure
  Decrease in the firm's price of the firms will decrease the consumption expenditure of the households.
- Savings for future consumption expenditure
  Decrease in the firm's price of the firms will increase the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – decrease in investors profit

decrease in the investors profit of the firm's expenses will decrease the following

- Decrease the firm's income
- Decrease the household's income
- Decrease the household's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and decrease in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Changes (decrease in investors profit) in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Firms Expense – other operating expense

Other operating expense in the product market will incur following changes.

- Increase in other operating expense
- Decrease in other operating expense

Increase in other operating expense

Increase in the operating expense will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – Increase in other operating expense

Increase in the other operating expense of the firm's expense will increase the firm's price of the firm's income.

Firms Incomes = Firms Expenses

Labour market – Increase in other operating expense

Increase in other operating expense of the firm's expense will increase the return on investment and rent of the household's income.

Increase in return on investment and rent of the household incomes will increase the expenses of the households in the following manner.

- Consumption expenditure
  Increase in the firm's price of the firms will increase the consumption expenditure of the households.
- Savings for future consumption expenditure
  Increase in the firm's price of the firms will decrease the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – Increase in other operating expense

Increase in the other operating expense of the firm's expenses will increase the following

- Increase the firm's income
- increase the household's income
- Increase the household's expense

supply of goods and services (Incomes of firms and households)

Increase in Firm's income and increase in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Changes (increase in other operating expense) in firm's expense and increase in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Decrease in other operating expense

Decrease in the operating expense will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – Decrease in other operating expense

Decrease in the other operating expense of the firm's expense will decrease the firm's price of the firm's income.

Firms Incomes = Firms Expenses

Labour market – decrease in other operating expense

Decrease in other operating expense of the firm's expense will decrease the return on investment and rent of the household's income.

decrease in return on investment and rent of the household incomes will decrease the expenses of the households in the following manner.

- Consumption expenditure
  Decrease in the firm's price of the firms will decrease the consumption expenditure of the households.
- Savings for future consumption expenditure
  Decrease in the firm's price of the firms will increase the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – decrease in other operating expense

decrease in the other operating expense of the firm's expenses will decrease the following

- Decrease the firm's income
- Decrease the household's income
- Decrease the household's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and decrease in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Changes (decrease in other operating expense) in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Firms Expense – supplier's price

Suppliers price in the product market will incur following changes.

- Increase in supplier's price
- Decrease in supplier's price

Increase in supplier's price

Increase in the supplier's price will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – Increase in supplier's price

Increase in the supplier's price of the firm's expense will increase the firm's price of the firm's income.

Firms Incomes = Firms Expenses

Labour market – Increase in supplier's price

Increase in supplier's price of the firm's expense will increase the wages or salaries interest, return on investment and rent of the household's income.

Increase in wages or salaries, interest, return on investment and rent of the household incomes will increase the expenses of the households in the following manner.

- Consumption expenditure
  Increase in the firm's price of the firms will increase the consumption expenditure of the households.
- Savings for future consumption expenditure
  Increase in the firm's price of the firms will decrease the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – Increase in supplier's price

Increase in the supplier's price of the firm's expenses will increase the following

- Increase the firm's income
- increase the household's income
- Increase the household's expense

supply of goods and services (Incomes of firms and households)

Increase in Firm's income and increase in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Changes (increase in supplier's price) in firm's expense and increase in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Decrease in supplier's price

Decrease in the supplier's price will have the impact on the following markets of an economy.

- Product market
- Labour market
- Aggregate market

Product market – Decrease in supplier's price

Decrease in the supplier's price of the firm's expense will decrease the firm's price of the firm's income.

Firms Incomes = Firms Expenses

Labour market – decrease in supplier's price

Decrease in supplier's price of the firm's expense will decrease the wages or salaries, interest, return on investment and rent of the household's income.

decrease in wages or salaries, interest, return on investment and rent of the household incomes will decrease the expenses of the households in the following manner.

- Consumption expenditure
  Decrease in the firm's price of the firms will decrease the consumption expenditure of the households.
- Savings for future consumption expenditure
  Decrease in the firm's price of the firms will increase the savings for future consumption expenditure of the households.

households Income = Households Expense

Aggregate market – decrease in supplier's price

decrease in the supplier's price of the firm's expenses will decrease the following

- Decrease the firm's income
- Decrease the household's income
- Decrease the household's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and decrease in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Changes (decrease in supplier's price) in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

LABOUR MODEL

Labour model is used to measure the impact on the economy due to the economic policies changes in the labour market.

The fundamental condition is that Household's Income equals Household's Expense.

households Income = Households Expense

Labour model is used to measure the impact of the economic policies in an economy by analysing the impact of the changes in one variable of the household's Income and Expense to the remaining variables of the household's Income and Expense.

Household's Income

- Consumption expenditure
- Savings for future consumption expenditure

Household's Expense

- Wages or salaries
- Interest
- Rent
- Return on investment

Wages or salaries + interest + rent + return on investment = consumption expenditure + savings for future consumption expenditure

Changes in the Households Income – wages or salaries

Wages or salaries in the labour market will incur following changes.

- Increase in wages or salaries
- Decrease in wages or salaries

Increase in wages or salaries

Increase in the wages or salaries will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Increase in wages or salaries

Increase in the wages or salaries of the household's income will increase the household's expenses in following manner.

- Consumption expenditure
  Increase in the wages or salaries of the household's income will increase the consumption expenditure share in the expenses of the households.

- Savings for future consumption expenditure
  Increase in the wages or salaries of the household's income will decrease the savings for future consumption expenditure share in the expenses of the households.

households Income = Households Expense

product market – Increase in wages or salaries

increase in the wages and salaries of the household's income will increase the employee salaries or wages of the firm's expense.

Increase in the consumption expenditure and decrease in the savings for future consumption expenditure of the household's expenses will increase firm's price of the firm's income.

Firms Incomes = Firms Expenses

Aggregate market – Increase in wages or salaries

Increase in the wage and salaries of the household's income will increase the following

- Increase the household's expense
- Increase the firm's income
- Increase the firm's expense

supply of goods and services (Incomes of firms and households)

increase in Firm's income and **Changes (Increase in wages or salaries)** in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

increase in firm's expense and increase in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

decrease in wages or salaries

decrease in the wages or salaries will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Decrease in wages or salaries

Decrease in the wages or salaries of the household's income will decrease the household's expenses in following manner.

- Consumption expenditure
  Decrease in the wages or salaries of the household's income will decrease the consumption expenditure share in the expenses of the households.

- Savings for future consumption expenditure
  Decrease in the wages or salaries of the household's income will increase the savings for future consumption expenditure share in the expenses of the households.

households Income = Households Expense

product market – Decrease in wages or salaries

Decrease in the wages and salaries of the household's income will decrease the employee salaries or wages of the firm's expense.

decrease in the consumption expenditure and increase in the savings for future consumption expenditure of the household's expenses will decrease firm's price of the firm's income.

Firms Incomes = Firms Expenses

Aggregate market – Decrease in wages or salaries

Decrease in the wage and salaries of the household's income will decrease the following

- Decrease the household's expense
- Decrease the firm's income
- decrease the firm's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and **Changes (decrease in wages or salaries)** in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Decrease in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Households Income – interest

Interest in the labour market will incur following changes.

- Increase in interest
- Decrease in interest

Increase in Interest

Increase in the interest will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Increase in Interest

Increase in the interest of the household's income will increase the household's expenses in following manner.

- Consumption expenditure
  Increase in the interest of the household's income will increase the consumption expenditure share in the expenses of the households.

- Savings for future consumption expenditure
  Increase in the interest of the household's income will decrease the savings for future consumption expenditure share in the expenses of the households.

households Income = Households Expense

product market – Increase in interest

increase in the interest of the household's income will increase the investors profit of the firm's expense.

Increase in the consumption expenditure and decrease in the savings for future consumption expenditure of the household's expenses will increase firm's price of the firm's income.

Firms Incomes = Firms Expenses

Aggregate market – Increase in interest

Increase in the interest of the household's income will increase the following

- Increase the household's expense
- Increase the firm's income
- Increase the firm's expense

supply of goods and services (Incomes of firms and households)

increase in Firm's income and **Changes (Increase in interest)** in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

increase in firm's expense and increase in households' expense will increase the demand for goods and services in the economy.

Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)

Decrease in Interest

Decrease in the interest will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Decrease in Interest

Decrease in the interest of the household's income will decrease the household's expenses in following manner.

- Consumption expenditure
  Decrease in the interest of the household's income will decrease the consumption expenditure share in the expenses of the households.

- Savings for future consumption expenditure
  Decrease in the interest of the household's income will increase the savings for future consumption expenditure share in the expenses of the households.

households Income = Households Expense

product market – Decrease in Interest

Decrease in the interest of the household's income will decrease the investors profit of the firm's expense.

decrease in the consumption expenditure and increase in the savings for future consumption expenditure of the household's expenses will decrease firm's price of the firm's income.

Firms Incomes = Firms Expenses

Aggregate market – Decrease in interest

Decrease in the interest of the household's income will decrease the following

- Decrease the household's expense
- Decrease the firm's income
- decrease the firm's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and **Changes (decrease in interest)** in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Decrease in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Households Income – Rent

Rent in the labour market will incur following changes.

- Increase in rent
- Decrease in rent

Increase in rent

Increase in the rent will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Increase in rent

Increase in the rent of the household's income will increase the household's expenses in following manner.

- Consumption expenditure
  Increase in the rent of the household's income will increase the consumption expenditure share in the expenses of the households.

- Savings for future consumption expenditure
  Increase in the rent of the household's income will decrease the savings for future consumption expenditure share in the expenses of the households.

households Income = Households Expense

product market – Increase in rent

increase in the rent of the household's income will increase the other operating expenses of the firm's expense.

Increase in the consumption expenditure and decrease in the savings for future consumption expenditure of the household's expenses will increase firm's price of the firm's income.

Firms Incomes = Firms Expenses

Aggregate market – Increase in rent

Increase in the rent of the household's income will increase the following

- Increase the household's expense
- Increase the firm's income
- Increase the firm's expense

supply of goods and services (Incomes of firms and households)

increase in Firm's income and **Changes (Increase in rent)** in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

increase in firm's expense and increase in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Decrease in rent

Decrease in the rent will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Decrease in rent

Decrease in the rent of the household's income will decrease the household's expenses in following manner.

- Consumption expenditure
  Decrease in the rent of the household's income will decrease the consumption expenditure share in the expenses of the households.

- Savings for future consumption expenditure
  Decrease in the rent of the household's income will increase the savings for future consumption expenditure share in the expenses of the households.

households Income = Households Expense

product market – Decrease in Interest

Decrease in the rent of the household's income will decrease the other operating expense of the firm's expense.

decrease in the consumption expenditure and increase in the savings for future consumption expenditure of the household's expenses will decrease firm's price of the firm's income.

Firms Incomes = Firms Expenses

Aggregate market – Decrease in rent

Decrease in the rent of the household's income will decrease the following

- Decrease the household's expense
- Decrease the firm's income
- decrease the firm's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and **Changes (decrease in rent)** in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Decrease in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Households Income – Return on investment

Return on investment in the labour market will incur following changes.

- Increase in return on investment
- Decrease in return on investment

Increase in return on investment

Increase in the return on investment will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Increase in return on investment

Increase in the return on investment of the household's income will increase the household's expenses in following manner.

- Consumption expenditure
  Increase in the return on investment of the household's income will increase the consumption expenditure share in the expenses of the households.

- Savings for future consumption expenditure
  Increase in the return on investment of the household's income will decrease the savings for future consumption expenditure share in the expenses of the households.

households Income = Households Expense

product market – Increase in return on investment

increase in the return on investment of the household's income will increase the other operating expenses and investors profit of the firm's expense.

Increase in the consumption expenditure and decrease in the savings for future consumption expenditure of the household's expenses will increase firm's price of the firm's income.

Firms Incomes = Firms Expenses

Aggregate market – Increase in return on investment

Increase in the return on investment of the household's income will increase the following

- Increase the household's expense
- Increase the firm's income
- Increase the firm's expense

supply of goods and services (Incomes of firms and households)

increase in Firm's income and **Changes (Increase in return on investment)** in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

increase in firm's expense and increase in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Decrease in return on investment

Decrease in the return on investment will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Decrease in return on investment

Decrease in the return on investment of the household's income will decrease the household's expenses in following manner.

- Consumption expenditure
  Decrease in the return on investment of the household's income will decrease the consumption expenditure share in the expenses of the households.

- Savings for future consumption expenditure
  Decrease in the return on investment of the household's income will increase the savings for future consumption expenditure share in the expenses of the households.

households Income = Households Expense

product market – Decrease in return on investment

Decrease in the return on investment of the household's income will decrease the other operating expense and investors profit of the firm's expense.

decrease in the consumption expenditure and increase in the savings for future consumption expenditure of the household's expenses will decrease firm's price of the firm's income.

Firms Incomes = Firms Expenses

Aggregate market – Decrease in return on investment

Decrease in the return on investment of the household's income will decrease the following

- Decrease the household's expense
- Decrease the firm's income
- decrease the firm's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and **Changes (decrease in return on investment)** in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Decrease in firm's expense and decrease in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Households Expense – Consumption expenditure

Consumption expenditure in the labour market will incur following changes.

- Increase in consumption expenditure
- Decrease in consumption expenditure

Increase in consumption expenditure

Increase in the consumption expenditure will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Increase in consumption expenditure

Increase in the consumption expenditure share of the household's expense will increase one or more of the incomes of the households as follows.

- Increase in the consumption expenditure share of the household's expense will increase the wages or salaries of the household's income
- Increase in the consumption expenditure share of the household's expense will increase the rent of the household's income
- Increase in the consumption expenditure share of the household's expense will increase the interest of the household's income
- Increase in the consumption expenditure share of the household's expense will increase the return on investment of the household's income

households Income = Households Expense

product market – Increase in consumption expenditure

Increase in consumption expenditure share of the household's expense will increase the firm' price of the firm's income.

Increase in one or more of the incomes of the households will increase their respective expenses of the firm's as follows.

- Increase in the wages or salaries of the household's income will increase the employee salaries or wages of the expenses of the firms.
- Increase in the rent of the household's income will increase the other operating expenses of the expenses of the firms.
- Increase in the interest of the household's income will increase the investors profit of the expenses of the firms.
- Increase in the return on investment of the household's income will increase the investors profit and other operating expense of the expenses of the firms.

Firms Incomes = Firms Expenses

Aggregate market – Increase in consumption expenditure

Increase in the consumption expenditure share of the household's expense will increase the following

- Increase the household's Income
- Increase the firm's income
- Increase the firm's expense

supply of goods and services (Incomes of firms and households)

Increase in Firm's income and increase in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Increase in firm's expense and **changes (increase in consumption expenditure share)** in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Decrease in consumption expenditure

Decrease in the consumption expenditure will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – decrease in consumption expenditure

decrease in the consumption expenditure share of the household's expense will decrease one or more of the incomes of the households as follows.

- Decrease in the consumption expenditure share of the household's expense will decrease the wages or salaries of the household's income
- Decrease in the consumption expenditure share of the household's expense will decrease the rent of the household's income
- Decrease in the consumption expenditure share of the household's expense will decrease the interest of the household's income
- Decrease in the consumption expenditure share of the household's expense will decrease the return on investment of the household's income

households Income = Households Expense

product market – Decrease in consumption expenditure

Decrease in consumption expenditure share of the household's expense will decrease the firm' price of the firm's income.

decrease in one or more of the incomes of the households will decrease their respective expenses of the firm's as follows.

- Decrease in the wages or salaries of the household's income will decrease the employee salaries or wages of the expenses of the firms.
- Decrease in the rent of the household's income will decrease the other operating expenses of the expenses of the firms.
- Decrease in the interest of the household's income will decrease the investors profit of the expenses of the firms.
- Decrease in the return on investment of the household's income will decrease the investors profit and other operating expense of the expenses of the firms.

Firms Incomes = Firms Expenses

Aggregate market – Decrease in consumption expenditure

Decrease in the consumption expenditure share of the household's expense will decrease the following

- Decrease the household's Income
- Decrease the firm's income
- Decrease the firm's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and decrease in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Decrease in firm's expense and **changes (decrease in consumption expenditure share)** in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

Changes in the Households Expense – savings for future Consumption expenditure

Savings for future Consumption expenditure in the labour market will incur following changes.

- Increase in savings for future consumption expenditure
- Decrease in savings for future consumption expenditure

Increase in savings for future consumption expenditure

Increase in the savings for future consumption expenditure will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Increase in savings for future consumption expenditure

Increase in the savings for future consumption expenditure share of the household's expense will decrease one or more of the incomes of the households as follows.

- Increase in the savings for future consumption expenditure share of the household's expense will decrease the wages or salaries of the household's income
- Increase in the savings for future consumption expenditure share of the household's expense will decrease the rent of the household's income
- Increase in the savings for future consumption expenditure share of the household's expense will decrease the interest of the household's income
- Increase in the savings for future consumption expenditure share of the household's expense will decrease the return on investment of the household's income

households Income = Households Expense

product market – Increase in savings for future consumption expenditure

Increase in savings for future consumption expenditure share of the household's expense will decrease the firm' price of the firm's income.

Decrease in one or more of the incomes of the households will decrease their respective expenses of the firm's as follows.

- Decrease in the wages or salaries of the household's income will decrease the employee salaries or wages of the expenses of the firms.
- Decrease in the rent of the household's income will decrease the other operating expenses of the expenses of the firms.
- Decrease in the interest of the household's income will decrease the investors profit of the expenses of the firms.
- Decrease in the return on investment of the household's income will decrease the investors profit and other operating expense of the expenses of the firms.

Firms Incomes = Firms Expenses

Aggregate market – Increase in savings for future consumption expenditure

Increase in the savings for future consumption expenditure share of the household's expense will decrease the following

- Decrease the household's Income
- Decrease the firm's income
- Decrease the firm's expense

supply of goods and services (Incomes of firms and households)

Decrease in Firm's income and decrease in Household's Income will decrease the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Decrease in firm's expense and **changes (Increase in savings for future consumption expenditure share)** in households' expense will decrease the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

decrease in savings for future consumption expenditure

Decrease in the savings for future consumption expenditure will have the impact on the following markets of an economy.

- Labour market
- Product market
- Aggregate market

Labour market – Decrease in savings for future consumption expenditure

Decrease in the savings for future consumption expenditure share of the household's expense will increase one or more of the incomes of the households as follows.

- Decrease in the savings for future consumption expenditure share of the household's expense will increase the wages or salaries of the household's income
- Decrease in the savings for future consumption expenditure share of the household's expense will increase the rent of the household's income
- Decrease in the savings for future consumption expenditure share of the household's expense will increase the interest of the household's income
- Decrease in the savings for future consumption expenditure share of the household's expense will increase the return on investment of the household's income

households Income = Households Expense

product market – Decrease in savings for future consumption expenditure

Decrease in savings for future consumption expenditure share of the household's expense will increase the firm' price of the firm's income.

Increase in one or more of the incomes of the households will increase their respective expenses of the firm's as follows.

- Increase in the wages or salaries of the household's income will increase the employee salaries or wages of the expenses of the firms.
- Increase in the rent of the household's income will increase the other operating expenses of the expenses of the firms.

- Increase in the interest of the household's income will increase the investors profit of the expenses of the firms.
- Increase in the return on investment of the household's income will increase the investors profit and other operating expense of the expenses of the firms.

Firms Incomes = Firms Expenses

Aggregate market – Decrease in savings for future consumption expenditure

Decrease in the savings for future consumption expenditure share of the household's expense will increase the following

- Increase the household's Income
- Increase the firm's income
- Increase the firm's expense

supply of goods and services (Incomes of firms and households)

Increase in Firm's income and Increase in Household's Income will increase the supply of goods and services in the economy.

Demand for goods and services (Expenses of firms and households)

Increase in firm's expense and **changes (decrease in savings for future consumption expenditure share)** in households' expense will increase the demand for goods and services in the economy.

> **Demand for goods and services (Expenses of firms and households) = supply of goods and services (Incomes of firms and households)**

CREATION, MEASUREMENT AND CONTROL OF AN EFFECTIVE ECONOMIC POLICY

To create, measure and control an effective economic policy for an economy, we must know the following information about the economic policy.

1. Effects of the economic policy on other variables of the economy.
2. Outcomes of the economic policy

Step -1

Identify the goal of the economic policy.

Step -2

Connect the goal of the economic policy to the below variables of firms and households to find the connecting variable of the economic policy.

1. Firm's variables
    - Firm's Income - Firm's price
    - Firm's expense – Employee salaries or wages
    - Firm's expense – Investors profit

- Firm's expense – Other operating expense
- Firm's expense – supplier's price

2. Household's variable
    - Household's Income – wages or salaries
    - Household's Income – interest
    - Household's Income – rent
    - Household's Income – return on investment
    - Household's expense – consumption expenditure
    - Household's expense – savings for future consumption expenditure

Step-3

After finding the connecting variable of the economic policy, we need to identify the market of the connecting variable.

1. Product market
   If the connecting variable of the economic policy belongs to the Firm's variables, then the connecting variable belongs to the product market.

2. Labour market
   If the connecting variable of the economic policy belongs to the Household's variables, then the connecting variable belongs to the labour market.

Step-4

After identifying the market of the connecting variable of the economic policy, we need to choose the model to analyse the effects of the economic policy on other variables of the economy and outcomes of the economic policy.

1. Production model
   If the connecting variable of the economic policy belongs to the product market, then we must use the production model to analyse the **changes in the connection variable** to know the following information during the creation of the economic policy.
    - Effects of the economic policy on other variables of the economy.
    - Outcomes of the economic policy

2. Labour model
   If the connecting variable of the economic policy belongs to the labour market, then we must use the labour model to analyse the **changes in the connection variable** to know the following information during the creation of the economic policy.
    - Effects of the economic policy on other variables of the economy.
    - Outcomes of the economic policy

Example

Minimum wages of the state are increased primarily to keep pace with inflation and the rising cost of living, ensuring that workers' purchasing power does not decline

Step -1

Identify the goal of the economic policy

Answer:

Increase in minimum wages.

Step -2

Connect the goal of the economic policy to the below variables of firms and households to find the connecting variable of the economic policy.

1. Firm's variables
    - Firm's Income - Firm's price
    - **Firm's expense – Employee salaries or wages**
    - Firm's expense – Investors profit
    - Firm's expense – Other operating expense
    - Firm's expense – supplier's price
2. Household's variable
    - Household's Income – wages or salaries
    - Household's Income – interest
    - Household's Income – rent
    - Household's Income – return on investment
    - Household's expense – consumption expenditure
    - Household's expense – savings for future consumption expenditure

Answer**:**

Goal of increase in minimum wages is connected to the firm's expense – Employee salaries or wages.

Step-3

After finding the connecting variable of the economic policy, we need to identify the market of the connecting variable.

1. Product market
   If the connecting variable of the economic policy belongs to the Firm's variables, then the connecting variable belongs to the product market.

2. Labour market
   If the connecting variable of the economic policy belongs to the Household's variables, then the connecting variable belongs to the labour market.

Answer**:**

connecting variable firm's expense – Employee salaries or wages belongs to the product market.

Step-4

After identifying the market of the connecting variable of the economic policy, we need to choose the model to analyse the effects of the economic policy on other variables of the economy and outcomes of the economic policy.

1. Production model
   If the connecting variable of the economic policy belongs to the product market, then we must use the production model to analyse the **changes in the connection variable** to know the following information during the creation of the economic policy.
   - Effects of the economic policy on other variables of the economy.
   - Outcomes of the economic policy

2. Labour model
   If the connecting variable of the economic policy belongs to the labour market, then we must use the labour model to analyse the **changes in the connection variable** to know the following information during the creation of the economic policy.
   - Effects of the economic policy on other variables of the economy.
   - Outcomes of the economic policy

Answer:

Changes in firm's expense – Employee salaries or wages (increase in employee salaries or wages) of the production model is used to analyse the effects of the economic policy on other variables of the economy and outcomes of the economic policy.

CONCLUSION

We can do the economic analysis of an economic regulations of an economy using the relationship between the following two interdependent agents of the economy.

1. Firms
   A Firm in an economy is started by the **investors** to make profit by buying the inputs from the **suppliers** and converting the inputs in to outputs for their **customers** using **employees and operation process.**

2. Households
   household in an economy create **Income** through the **supply of Labour (**To earn Wages or Salaries), **supply of Land** (To earn Rent) and **supply of Capital** (To earn Interest or Return on Investment) and spend the part of the income to **consume** the goods and services of the firms and **save** the remaining part of the income for future consumption.