

## MACROECONOMICS AT WORK EXERCISE

### DETERMINANTS OF AGGREGATE ECONOMIC ACTIVITY

**REFERENCE:** ‘Can profits save the economy?’ (by Rob Norton), *Fortune*, 11 November 2002, p.16.

**CHAPTERS RELEVANT TO THIS EXERCISE:** Chapters 6, 7, 11 and 13.

#### OVERVIEW

This article, written about the US economy in late 2002, focuses on the profit results of US businesses (referred to as ‘corporate profits’) and the significance of these results for aggregate economic activity. The discussion requires an understanding of the concept of GDP and the determinants of GDP. With a (relatively) few exceptions, the profits reported by US firms for the quarter ended September (2002) were solid, up 10 per cent over the same quarter from the previous year, contrary to the expectations of many commentators given the relatively subdued growth in the overall level of economic activity. These results were not *in themselves* of great significance. (Business profits represent only about 10 per cent of GDP, the balance accruing to owners of the factors of production, most importantly labour – refer to pp. 123–33 on the different ways of measuring GDP.) However, an important component of aggregate demand, business investment, *is* heavily influenced by business profits. More significantly, however, business profits have a pervasive influence on GDP in so far as they influence *other* components of aggregate demand and it for this reason that it is argued that the better-than-expected recent profit results could ‘save the economy’.

#### QUESTIONS

1. Why were the September corporate profit results better than expected and why have they been seen as a possible means of pulling the US economy in an upward direction?
2. How good are the results in fact?
3. Explain the statement that corporate profits constitute only about 10 per cent of GDP. What are the main reasons for the profit results being more significant than this figure may indicate?
4. Explain the mechanics of how the increase in corporate profits may have a positive effect on a number of elements of aggregate demand.
5. Explain the reference in the article to ‘serendipitous synchronicity’.
6. Expand on the notion of ‘the unintended consequences of a war with Iraq’ acting as one of the factors that could undermine the positive effects of the increase in corporate profits.