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Extending the Analysis of Aggregate Supply

From Short Run to Long Run

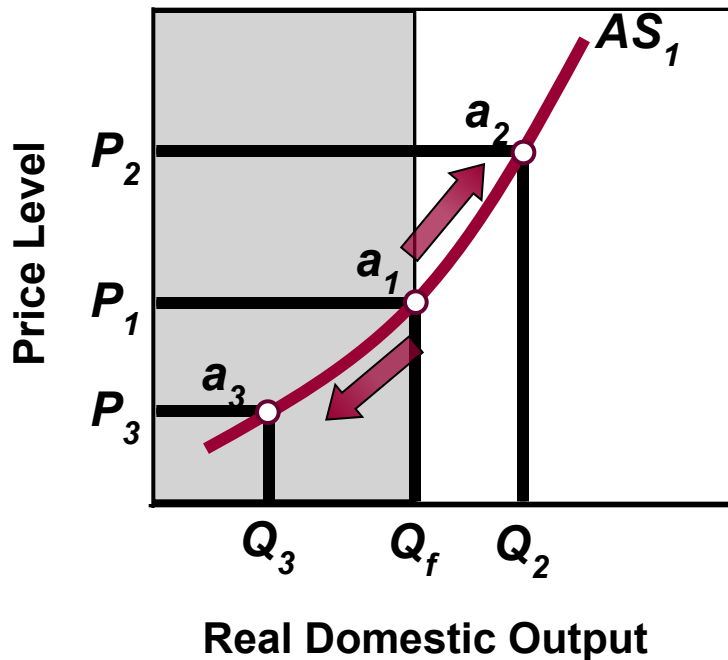
- Short run
 - Input prices inflexible
 - Upsloping aggregate supply
- Long run
 - Input prices fully flexible
 - Vertical aggregate supply
- The transition?

From Short Run to Long Run

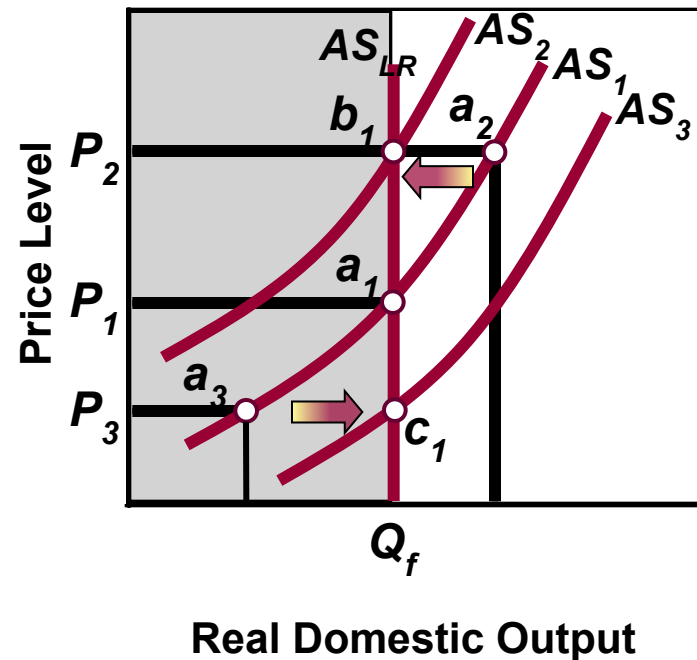
- Production above potential output:
 - High demand for inputs
 - Input prices rise
 - Short run aggregate supply shifts left
 - Return to potential output
- Production below potential output
- Graphical examples...

From Short Run to Long Run

Short-Run Aggregate Supply

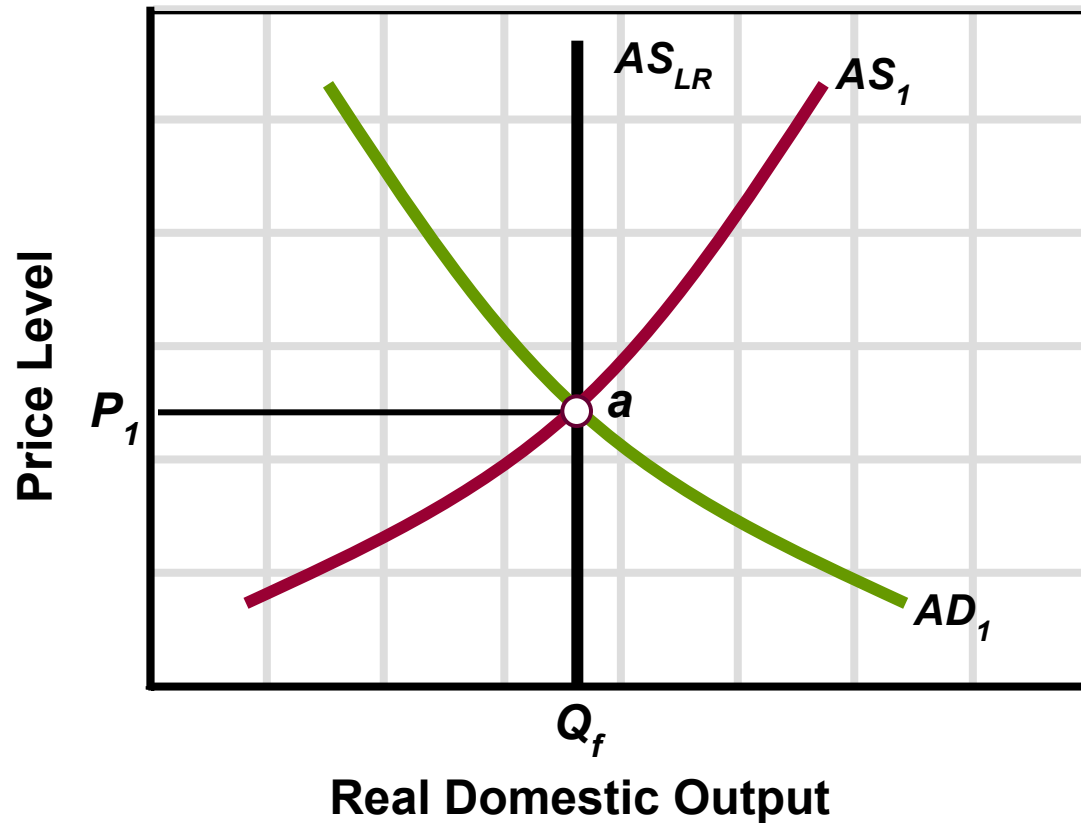


Long-Run Aggregate Supply



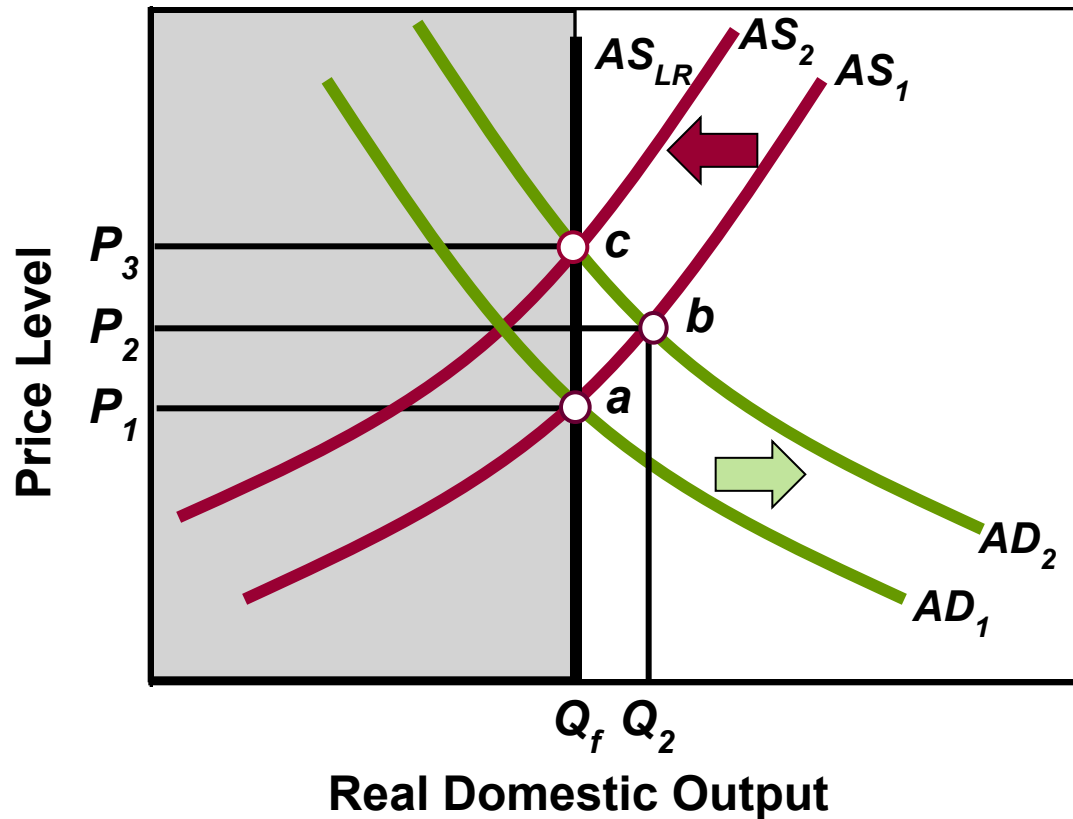
From Short Run to Long Run

Long Run Equilibrium



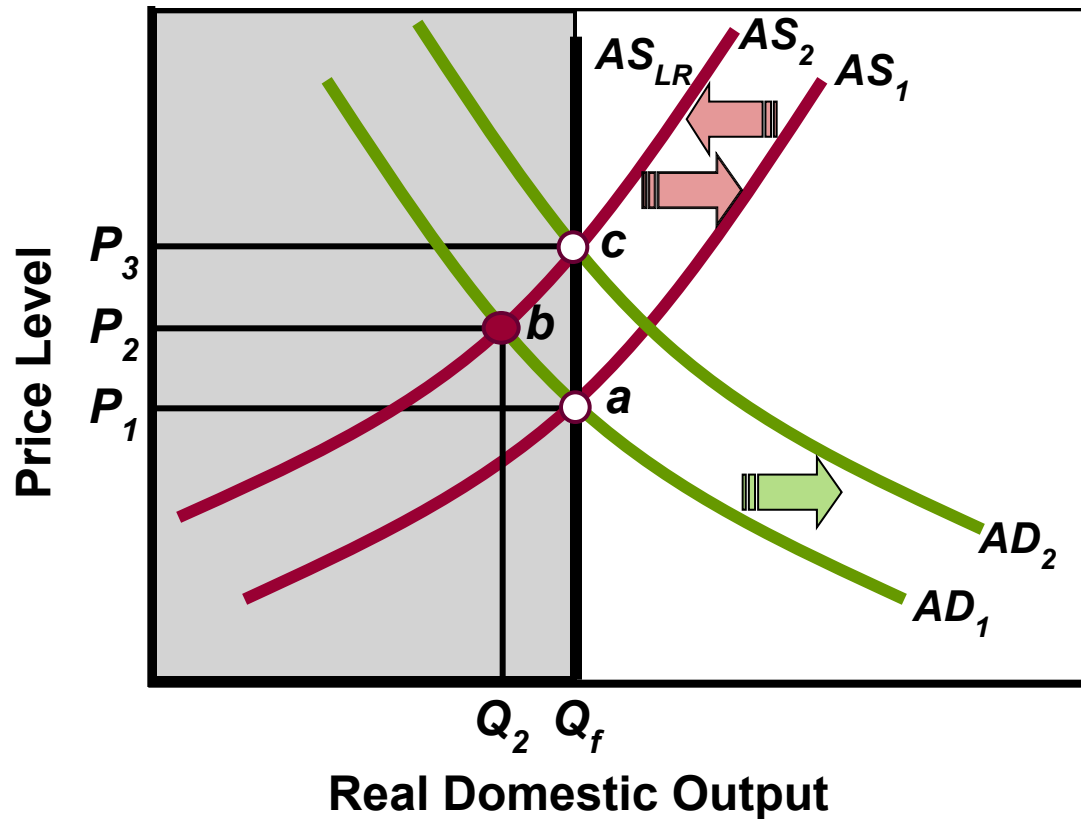
Extended AD-AS Model

Demand-Pull Inflation



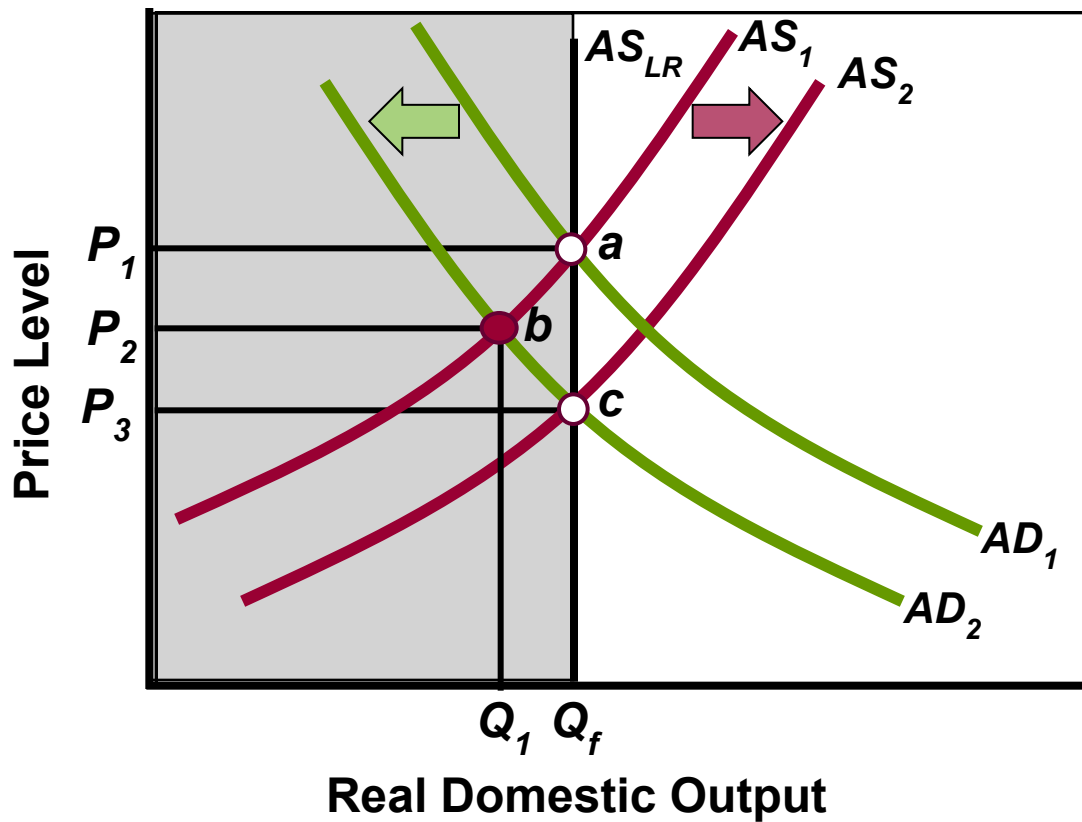
Extended AD-AS Model

Cost-Push Inflation



Extended AD-AS Model

Recession

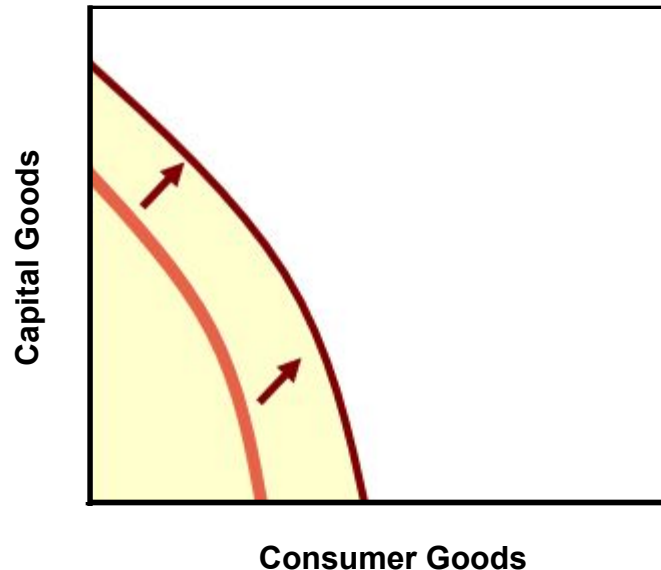


Extended AD-AS Model

- Explaining ongoing inflation
 - Ongoing economic growth shifts aggregate supply
 - Ongoing increases in money supply shift aggregate demand
- Small positive rate of inflation

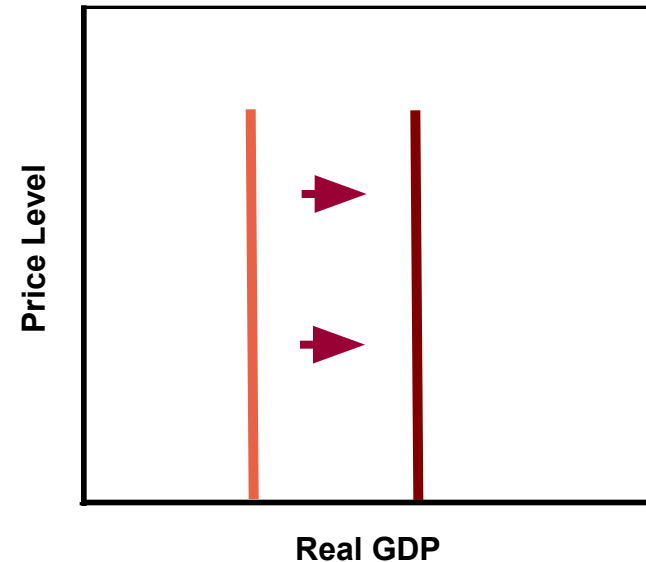
Economic Growth, Ongoing Inflation

Productions Possibilities



Increase in production possibilities

Long Run Aggregate Supply



Increase in long-run aggregate supply

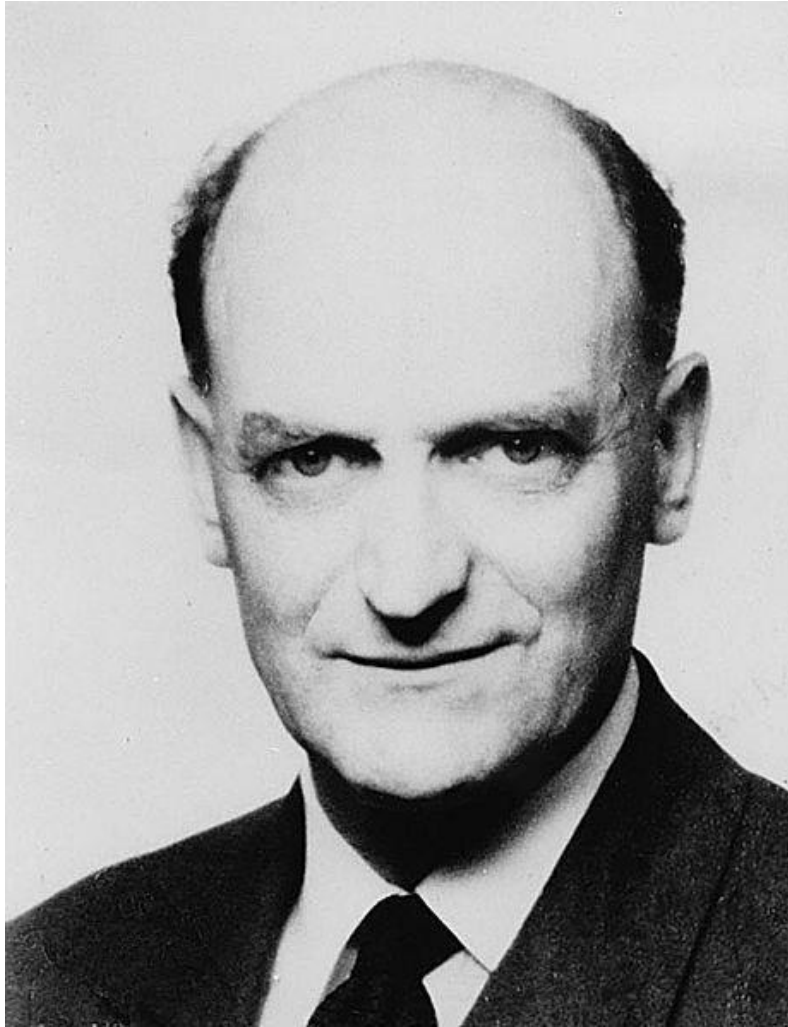
Inflation and Unemployment

- Low inflation and unemployment
 - Fed's major goals
 - Compatible or conflicting?
- Short-run tradeoff
- Supply shocks cause both rates to rise
- No long-run tradeoff

The Phillips Curve

- 1960s economists believed in stable, predictable tradeoff
- Phillips curve shifts over time
- Adverse supply shocks 1970s
 - OPEC oil price shock
 - Stagflation
- Stagflation's demise 1980s

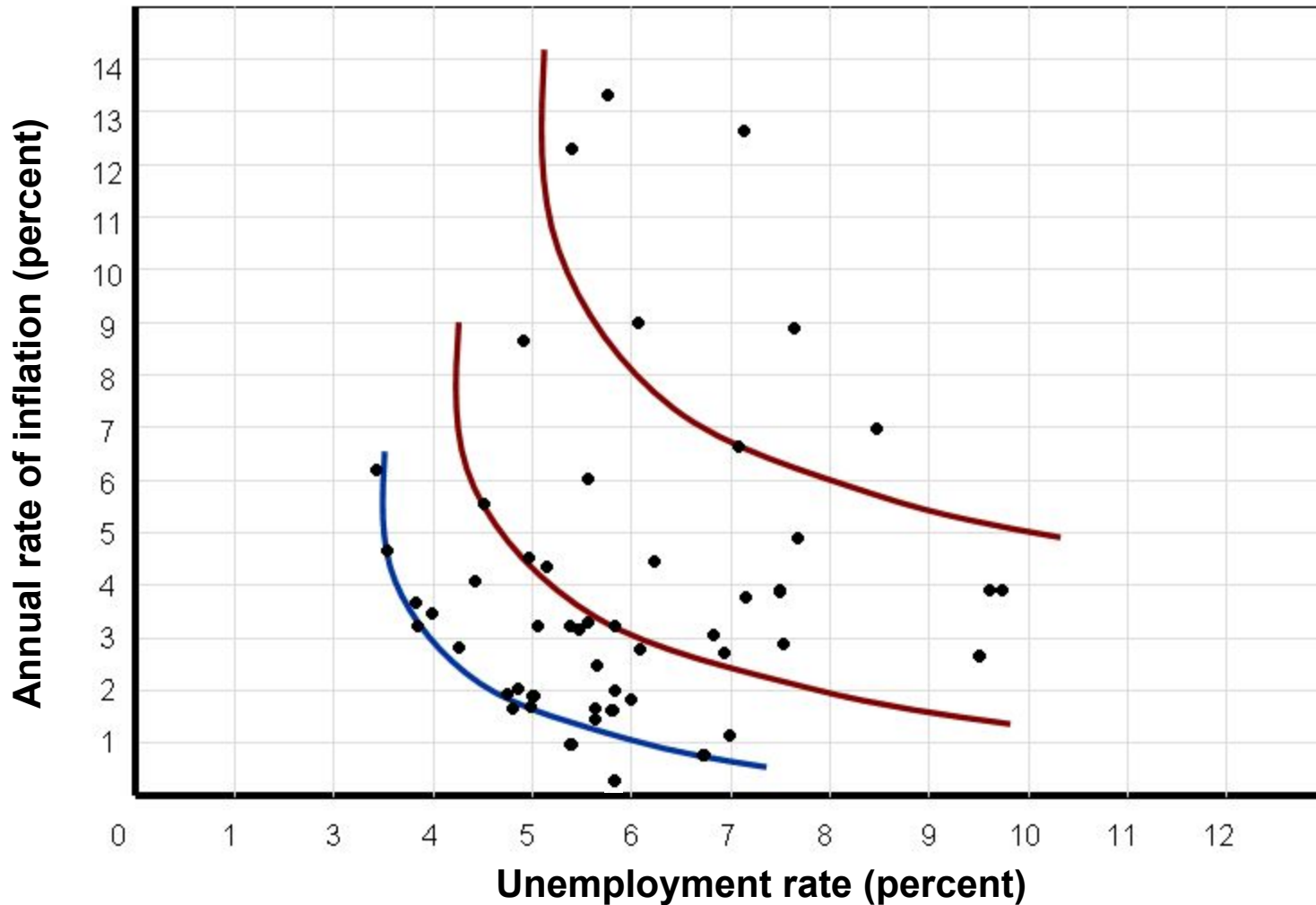
Alban William Phillips



The Phillips Curve

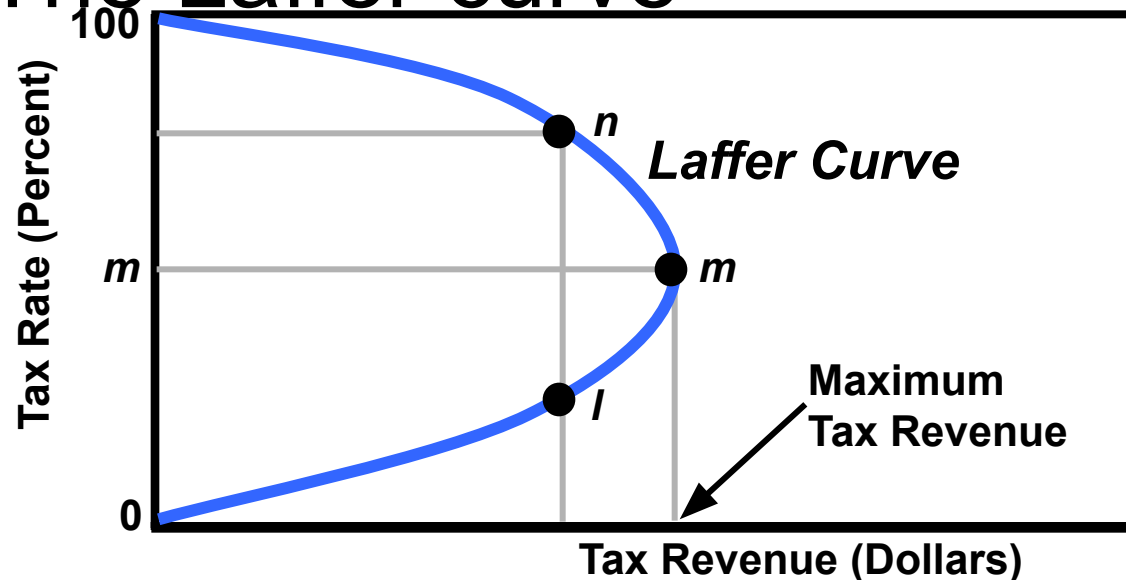
- No long-run tradeoff between inflation and unemployment
- Short-run Phillips curve
 - Role of expected inflation
- Long-run vertical Phillips curve
- Disinflation (increase the purchasing power of the local currency that is shown in the reduction of the price index)

The Phillips Curve



Taxes and Aggregate Supply

- Supply-side economics
- Tax incentives to work
- Tax incentives to save and invest
- The Laffer curve



Taxes and Aggregate Supply

- Criticisms of the Laffer curve
 - Taxes, incentives, and time
 - Inflation and higher real interest rates
 - Position on the curve
- Rebuttal and evaluation