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# Extending the Analysis of Aggregate Supply

# From Short Run to Long Run

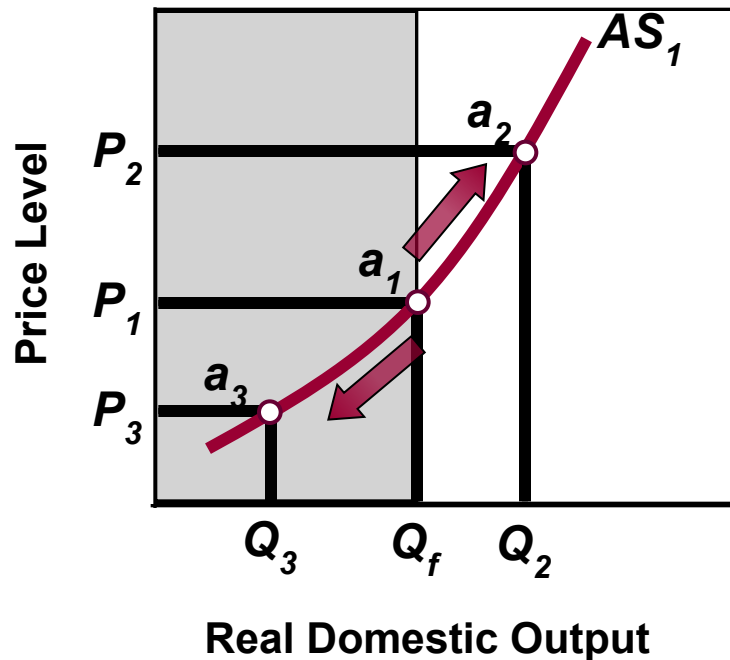
- Short run
  - Input prices inflexible
  - Upsloping aggregate supply
- Long run
  - Input prices fully flexible
  - Vertical aggregate supply
- The transition?

# From Short Run to Long Run

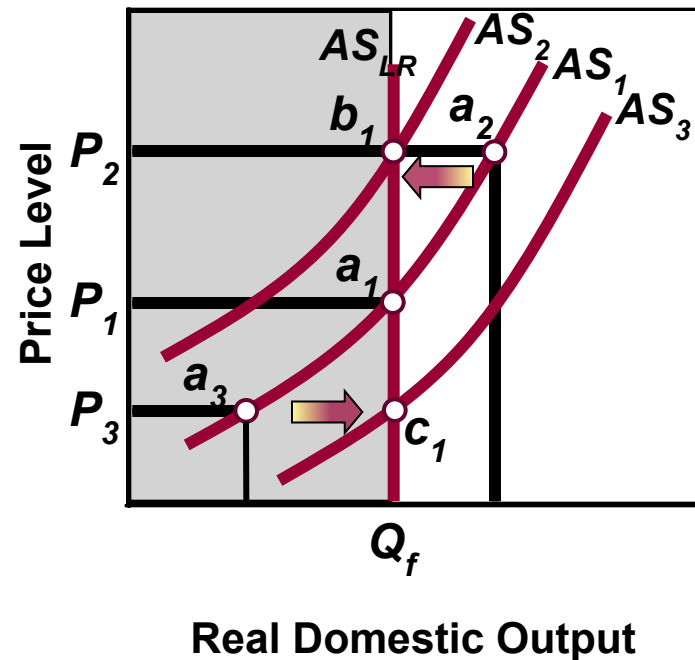
- Production above potential output:
  - High demand for inputs
  - Input prices rise
  - Short run aggregate supply shifts left
  - Return to potential output
- Production below potential output
- Graphical examples...

# From Short Run to Long Run

## Short-Run Aggregate Supply

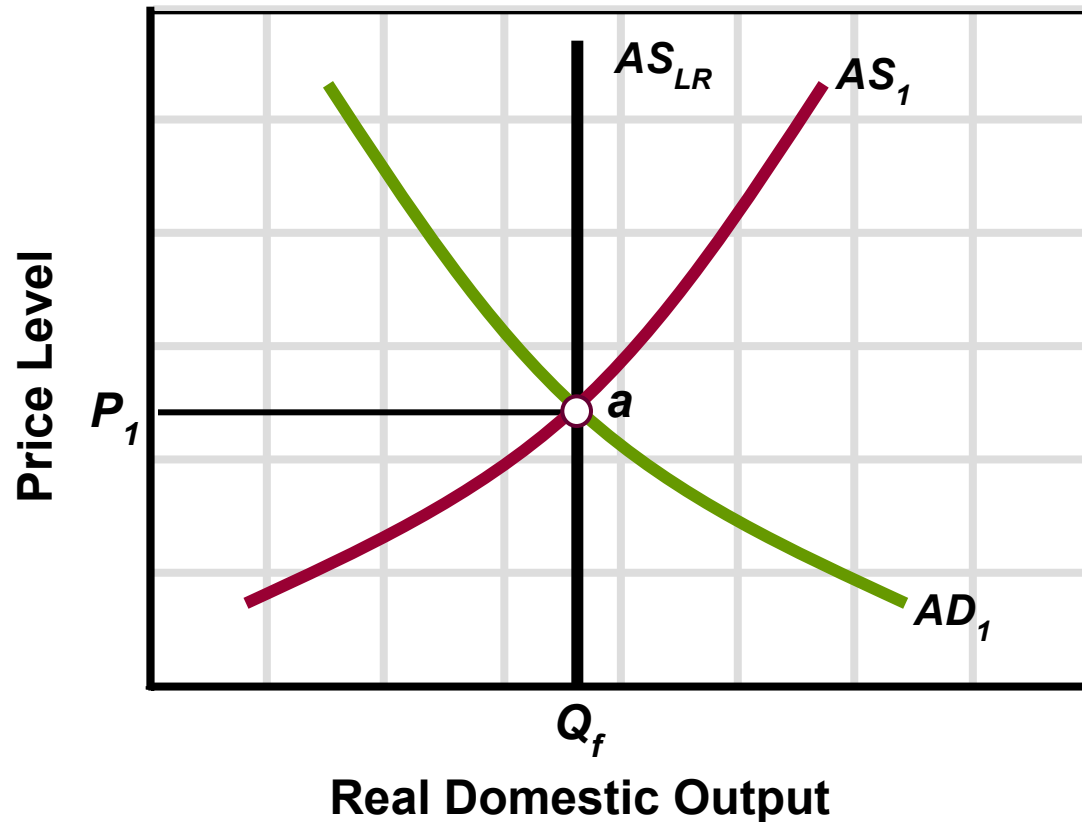


## Long-Run Aggregate Supply



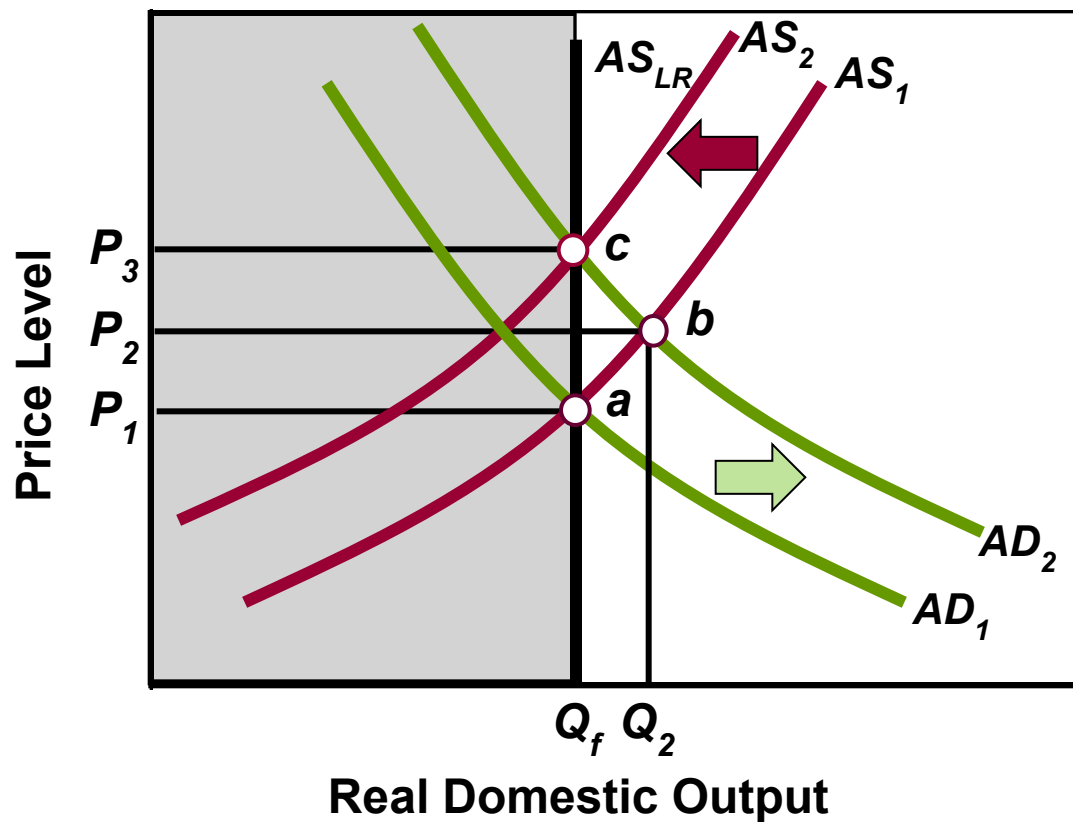
# From Short Run to Long Run

## Long Run Equilibrium



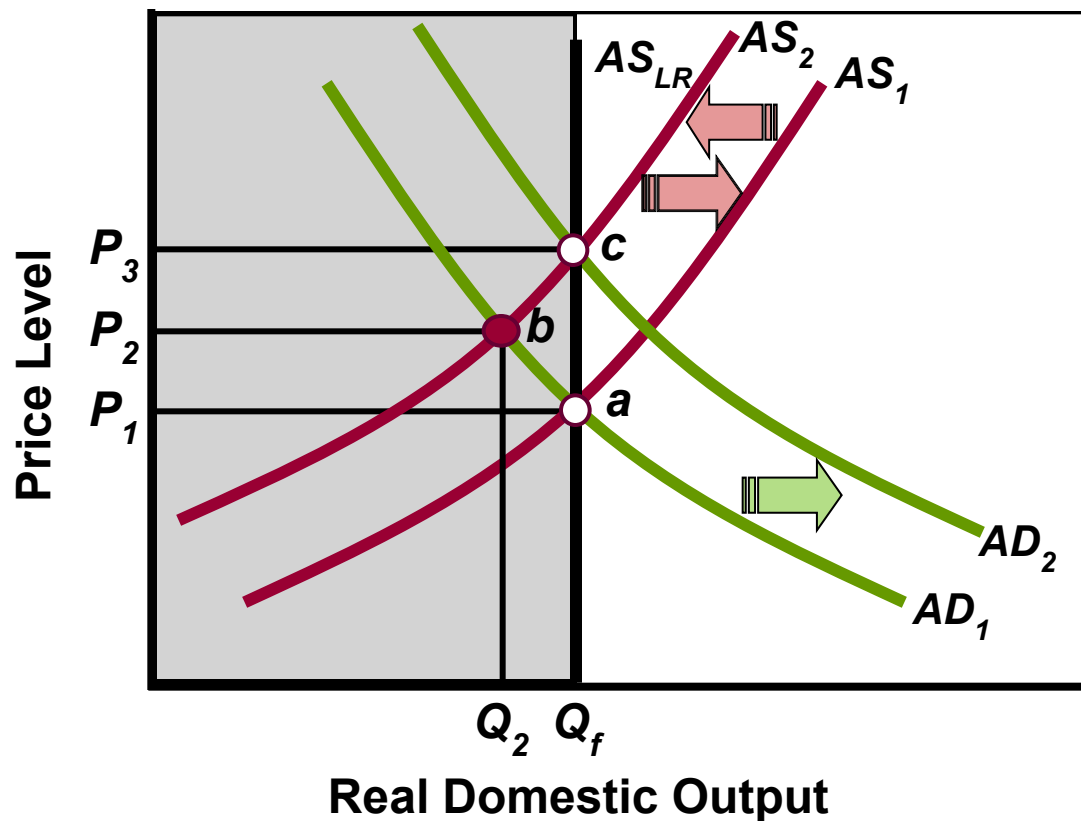
# Extended AD-AS Model

## Demand-Pull Inflation



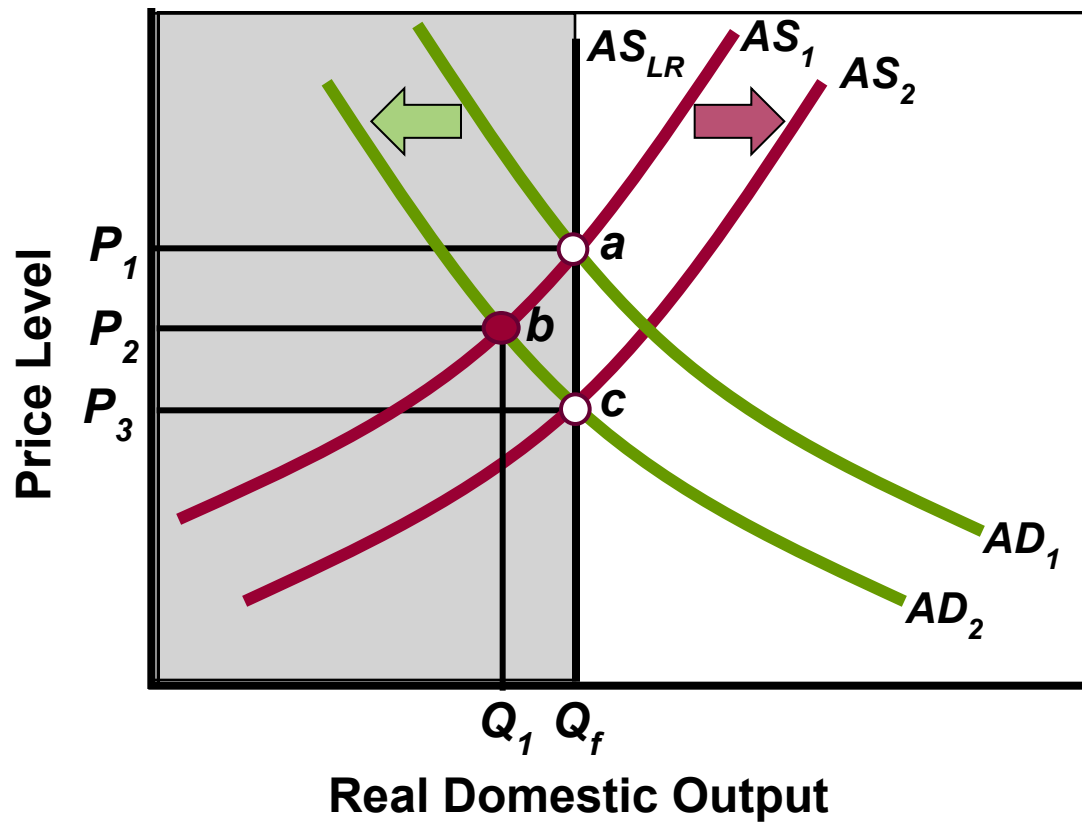
# Extended AD-AS Model

## Cost-Push Inflation



# Extended AD-AS Model

## Recession



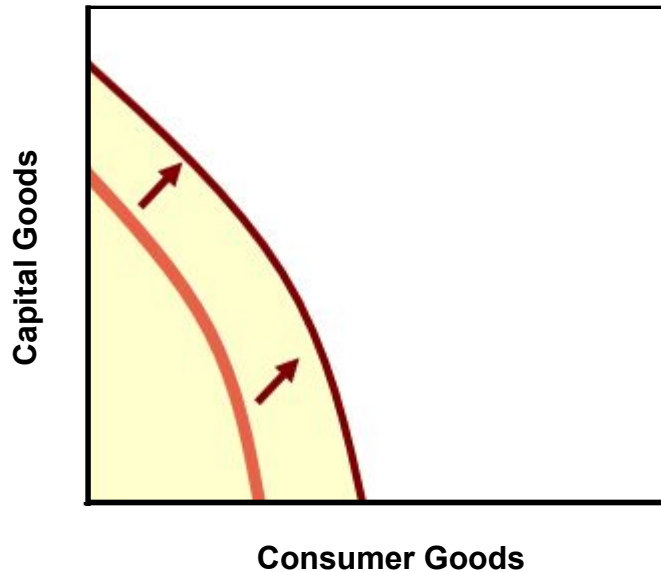


# Extended AD-AS Model

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

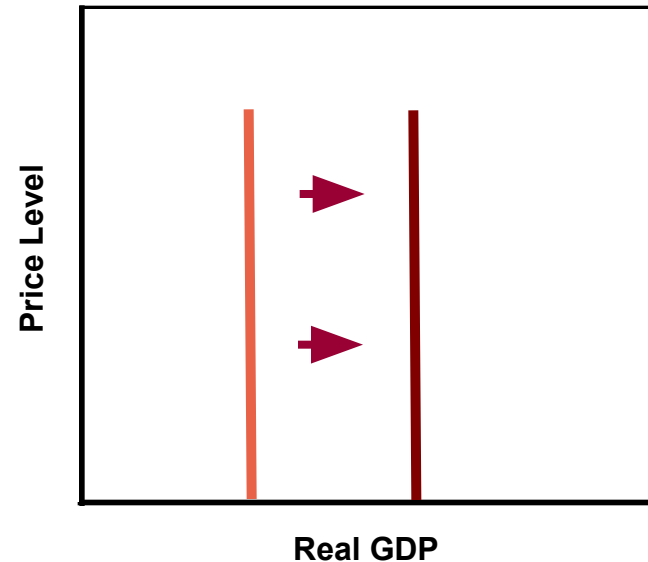
# Economic Growth, Ongoing Inflation

## Productions Possibilities



**Increase in production possibilities**

## Long Run Aggregate Supply



**Increase in long-run aggregate supply**

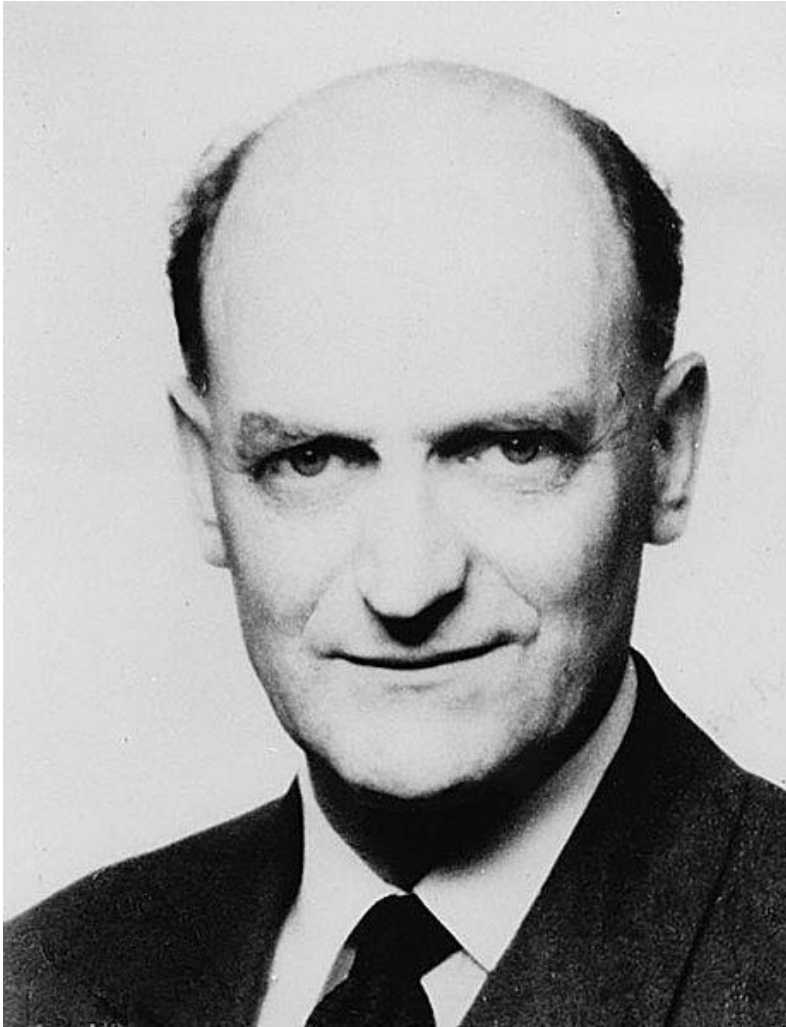
# Inflation and Unemployment

- 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

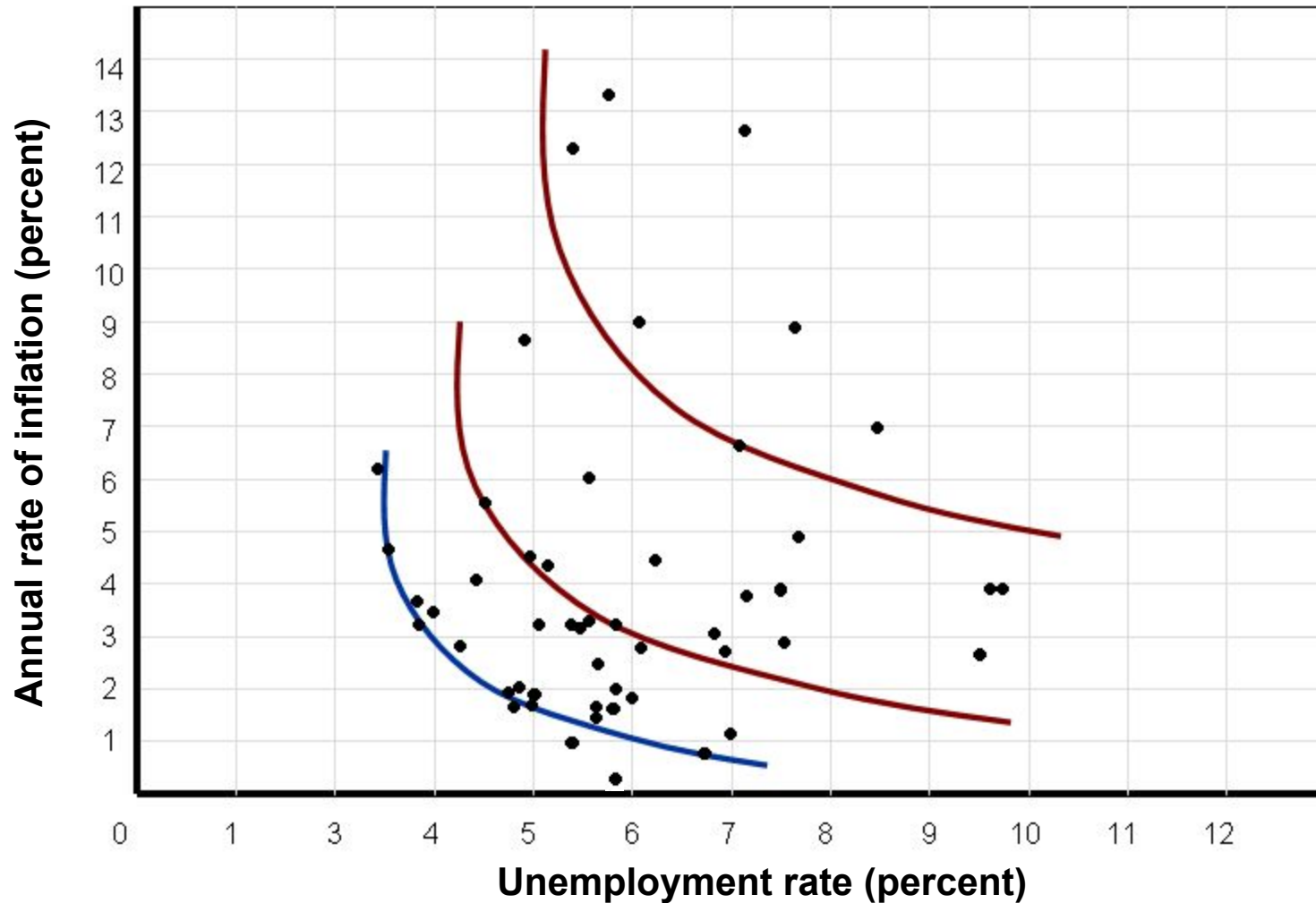
# *Alban William Phillips*



# The Phillips Curve

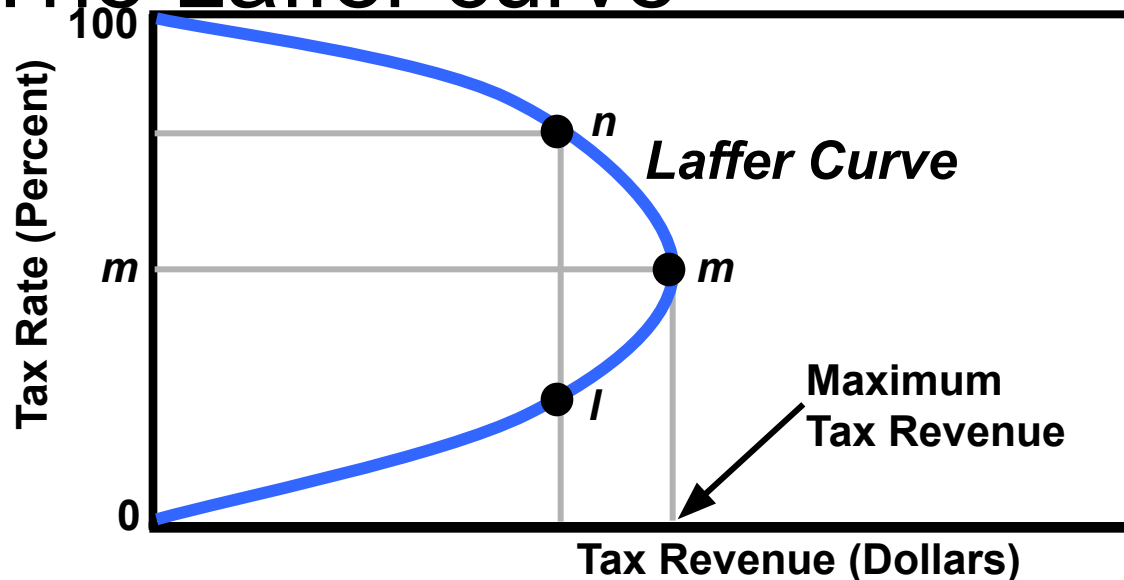
- No long-run tradeoff between inflation and unemployment
- Short-run Phillips curve
  - Role of expected inflation
- Long-run vertical Phillips curve
- Disinflation (increase the purchasing power of the local currency that is shown in the reduction of the price index)

# 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