

EE312:Macroeconomics Theory:

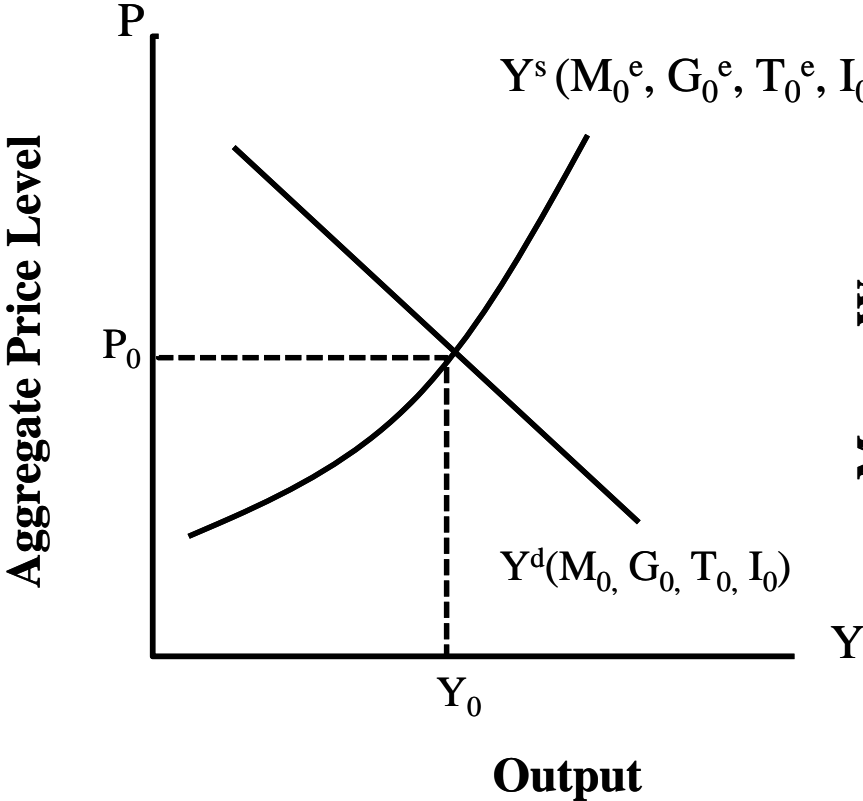
New Classical Economics

Real Business Cycles

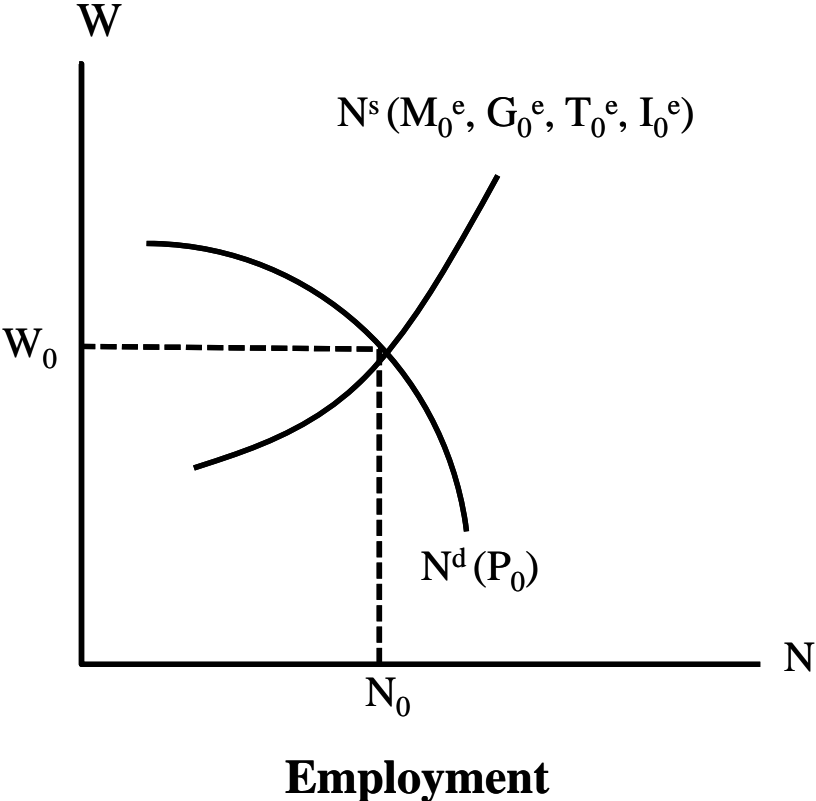
New Keynesian economics

Output and Employment in the New Classical Model

a. Aggregate Supply and Demand

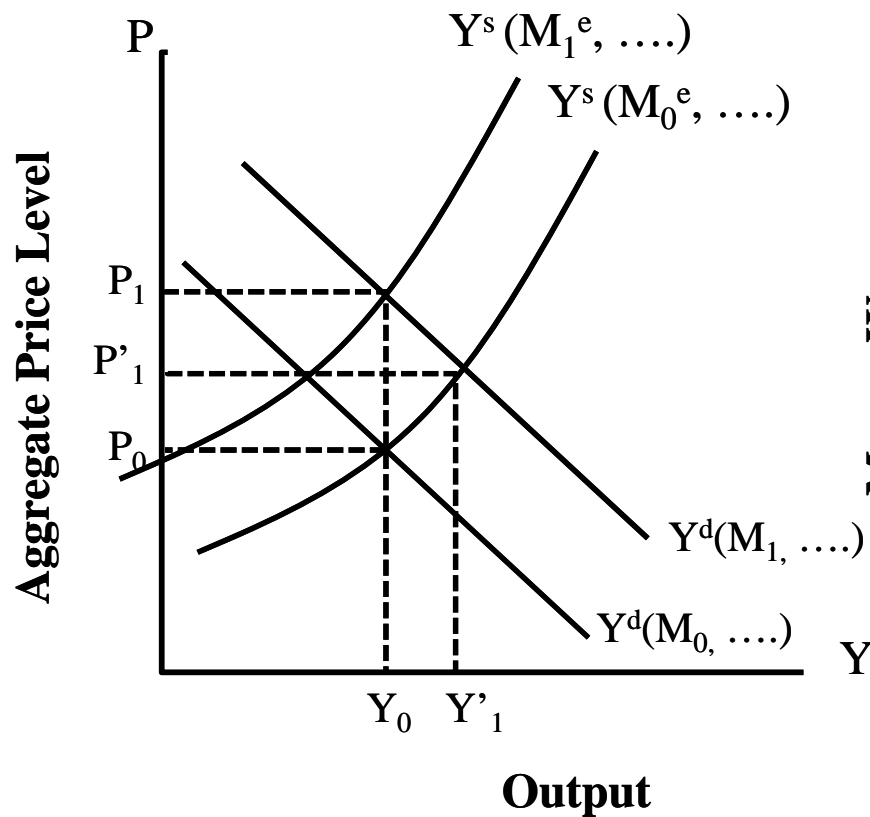


b. Labor Market

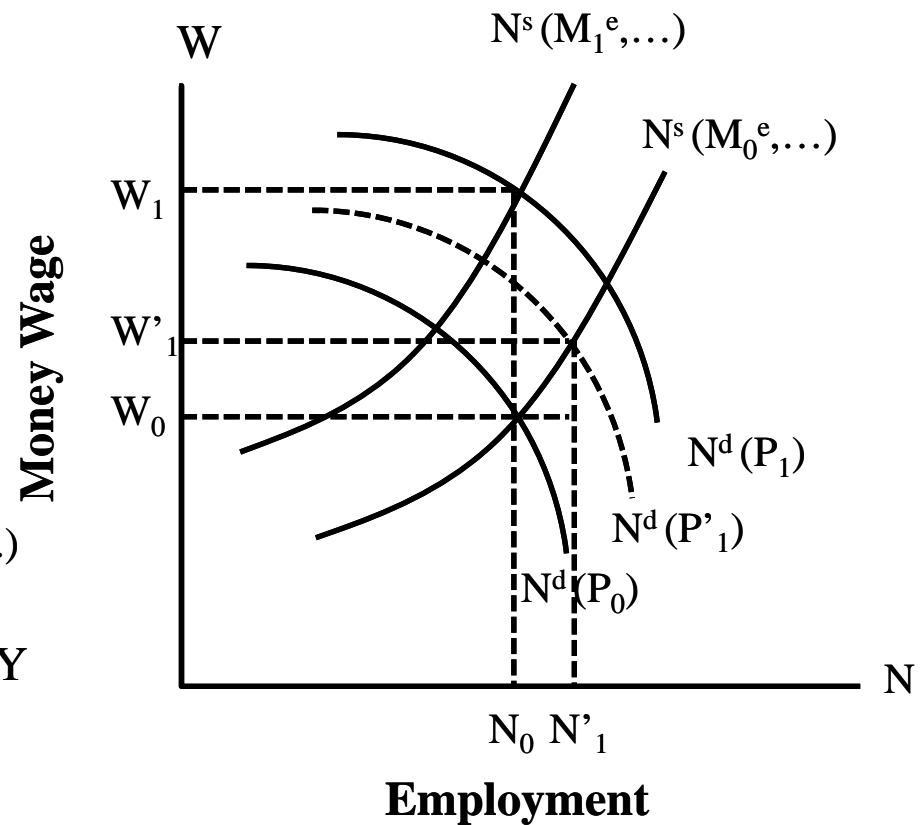


Effects of an Increase in the Money Supply: The New Classical View

a. Aggregate Supply and Demand

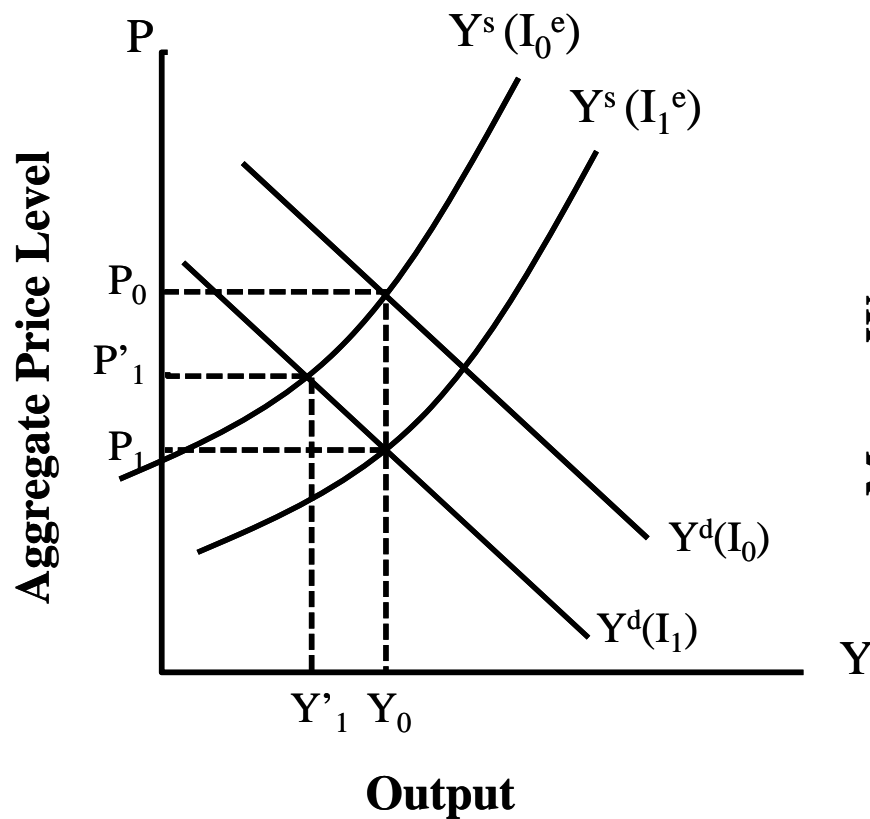


b. Labor Market

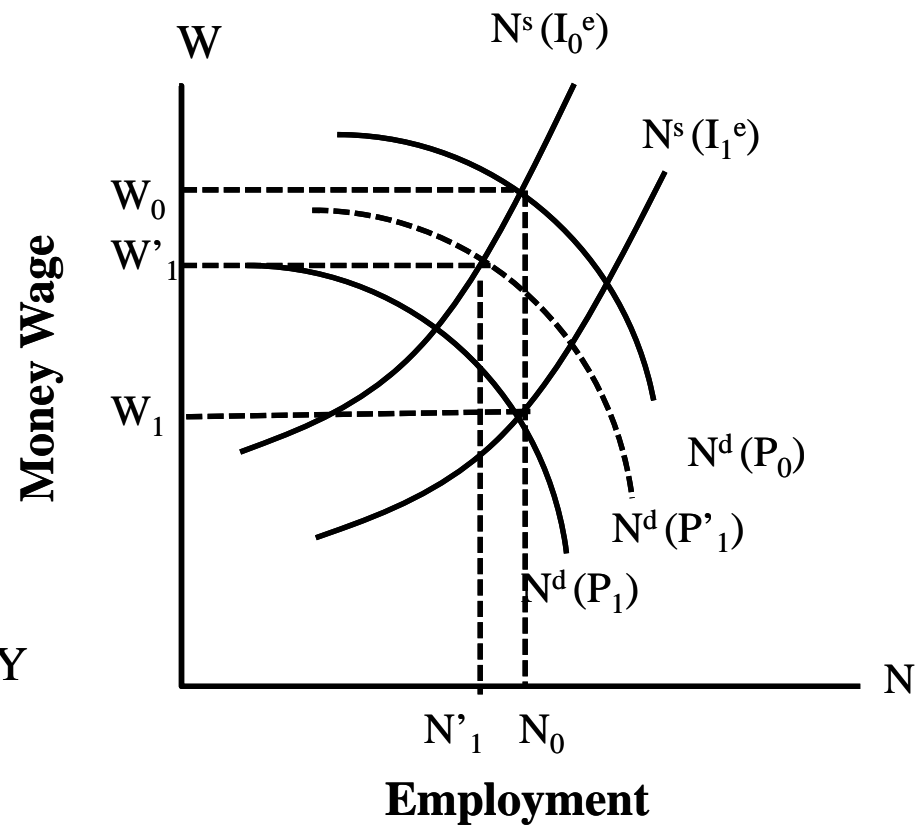


Effects of An autonomous Decline in Investment: A New Classical Model

a. Aggregate Supply and Demand

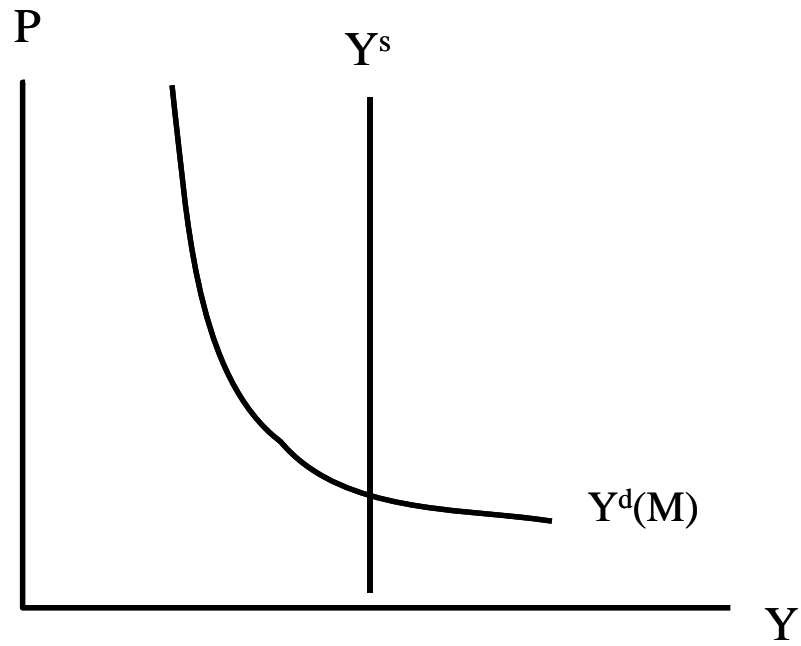


b. Labor Market

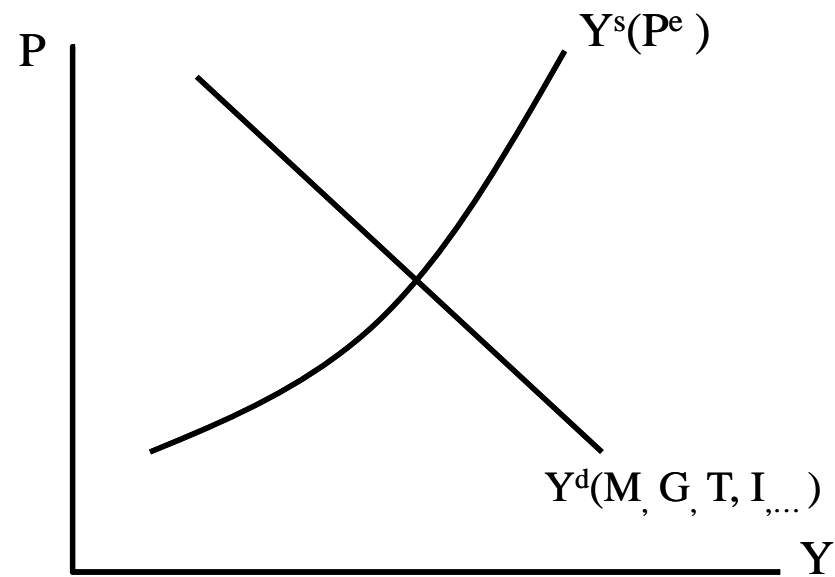


Macroeconomic Models: A Summary

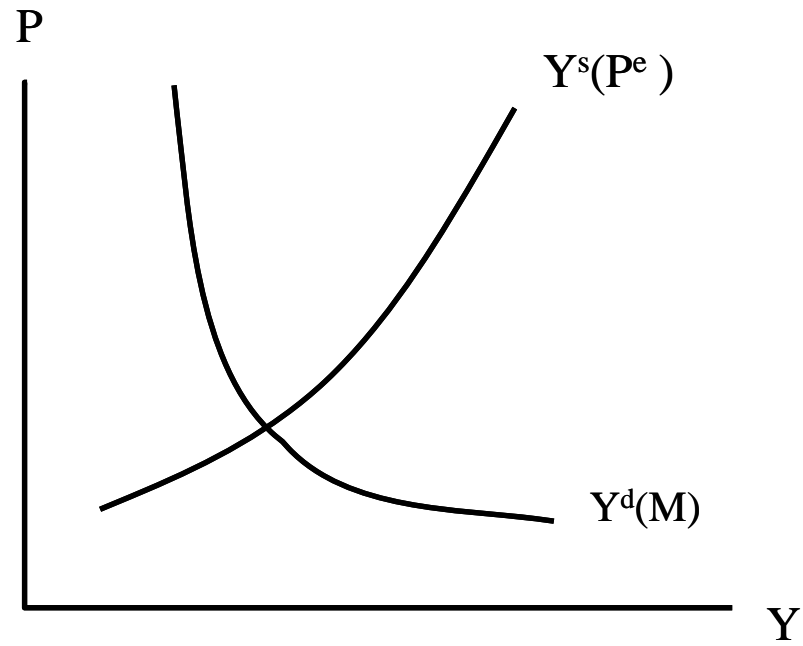
a. Classical Case



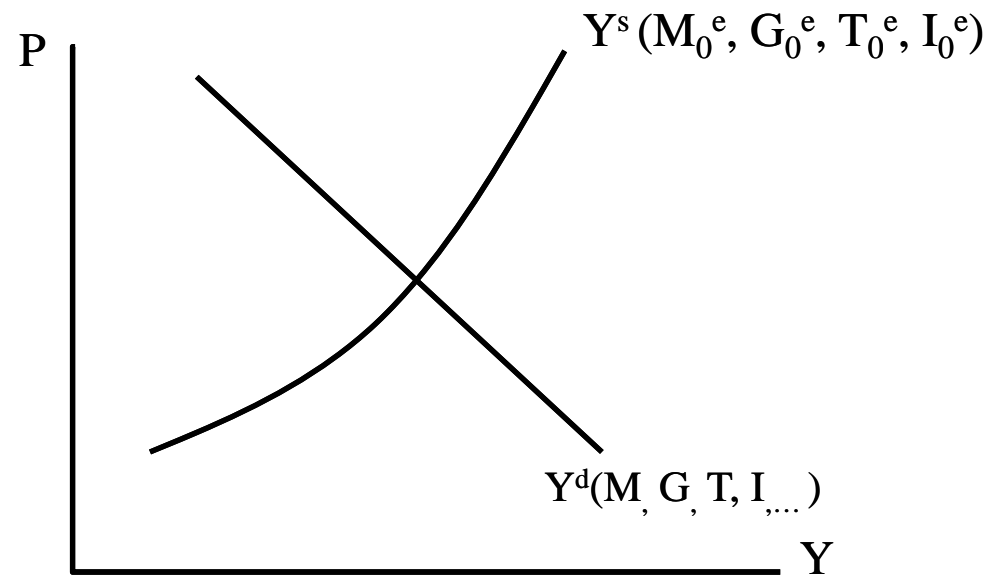
b. Keynesian Case



c. Monetarist Case



d. New Classical Case

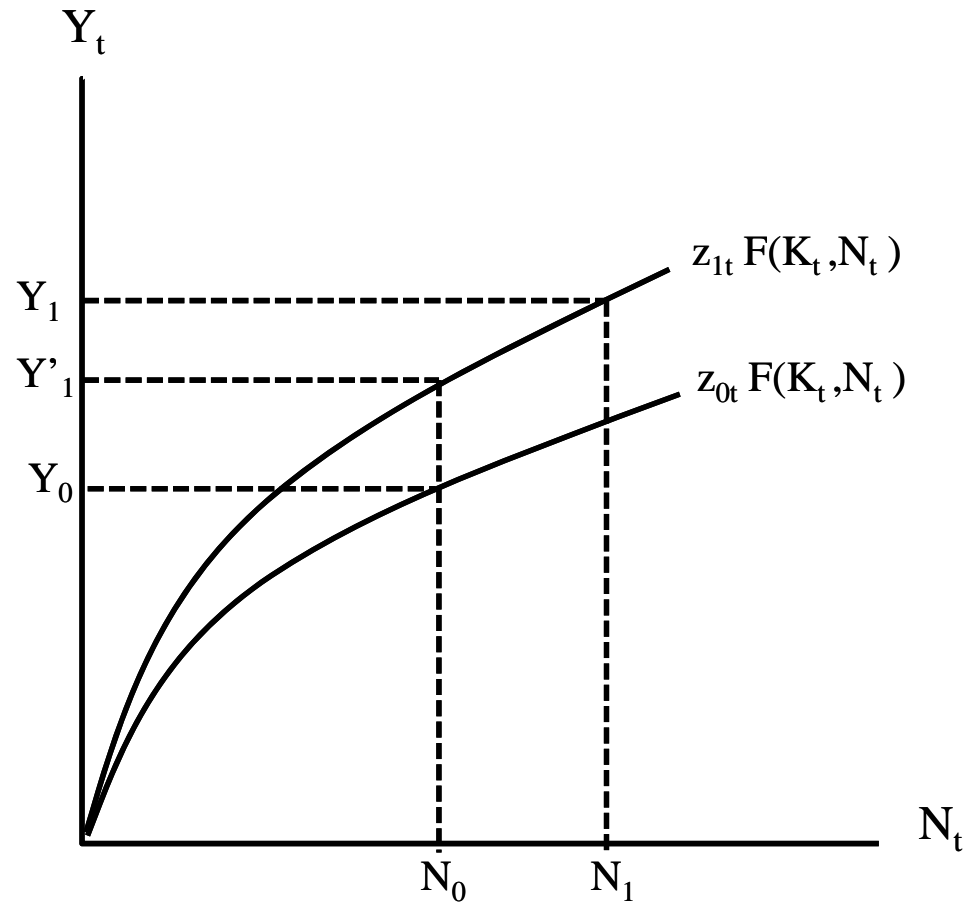




Real Business Cycle Model

- RBC agrees with the new classical economists that macroeconomic models should have 2 characteristics:
 1. Agents optimize.
 2. Markets clear.
- In RBC models, all unemployment is voluntary.
- Real supply-side factors are more important than demand-side influences.

The Effects of a Positive Technology Shock in a Real Business Cycle Model



New Keynesian Economics:

(Wage and price rigidities are central to Keynes's explanation of involuntary unemployment; need to have explanation based on microeconomic foundation)

- Imperfect competition
- Product price rigidity
- Real rigidity in addition to nominal rigidity

Three types of New Keynesian models

- 1. Sticky Price model
(Menu cost model)

Costs of changing prices prevent price adjustments when demand changes.

- managerial costs: cost of gathering information required to decide on the optimal price change, cost of communicating to customers who resist the change, etc.
- loss of consumer goodwill
- price reduction may set off competitive rounds of price cuts

- 2. Efficiency wage models
 - Models in which labor productivity depends on the real wage paid to workers
 - Real wage is set to maximize the efficiency units of labor per value of expenditure, not to clear the labor market.
 - Several rationales for the payment of efficiency wages: shirking model, turnover cost model, gift exchange model.

- 3. Insider-Outsider Models
- - provides an explanation for “*unemployment trap*”
- - Union members are “insiders” who have bargaining power with employers because it is costly to replace them with “outsiders” or nonunion members. With a higher real wage. Employment will remain lower than in the pre-recession period.