

Topic

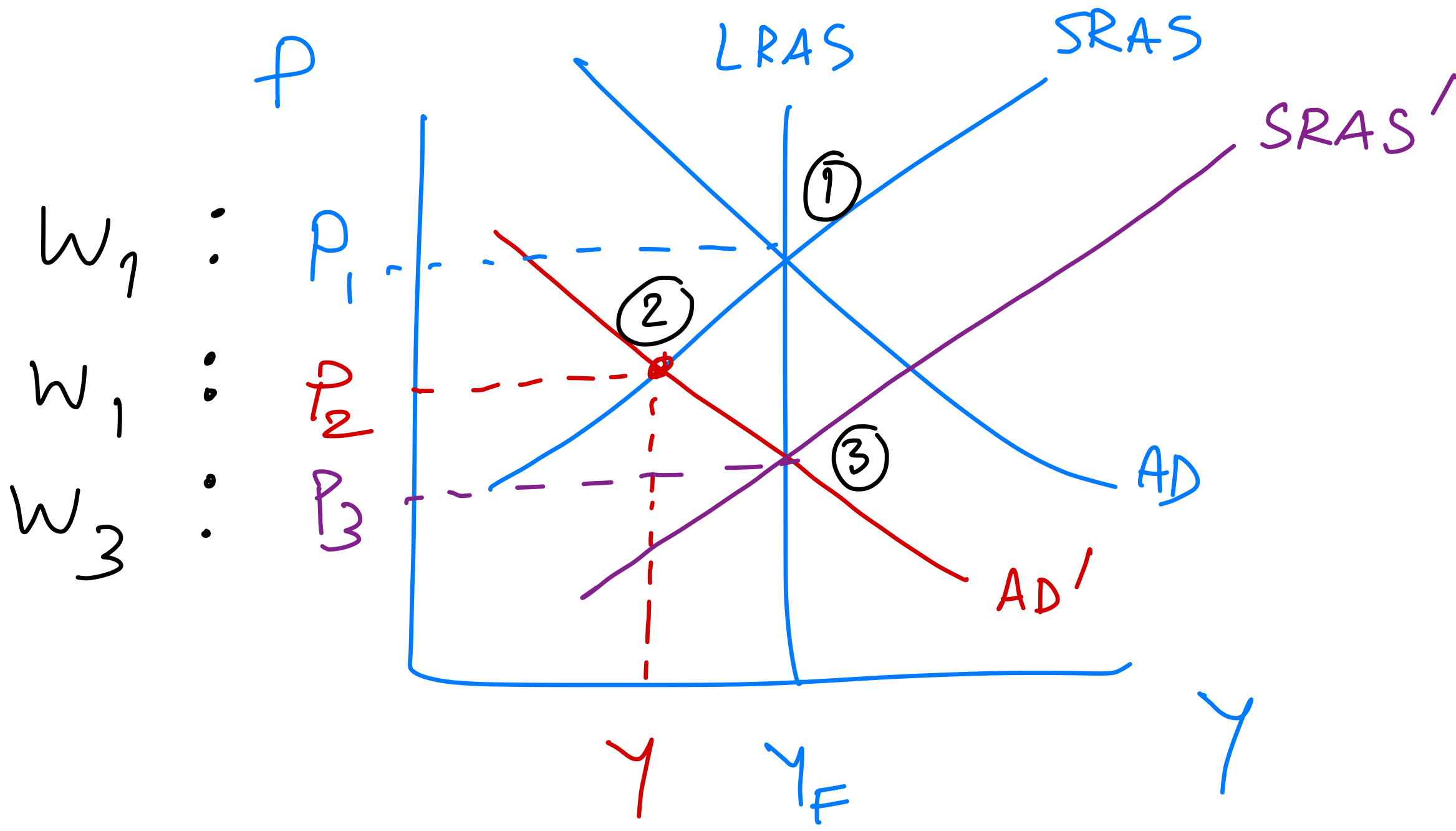
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Part

4

Neo-classical

- ① market is perfect & self-correcting.
- ② in SR, wage is rigid due to contract.
- ③ in LR, price & wage are flexible.
- ④ in LR, price & wage adjust in all markets and full employment is reached.
- ⑤ govt does not need to intervene.
economy will eventually reach Y_F .



$P \downarrow \rightarrow w \downarrow$

In Great Depression (1930s)

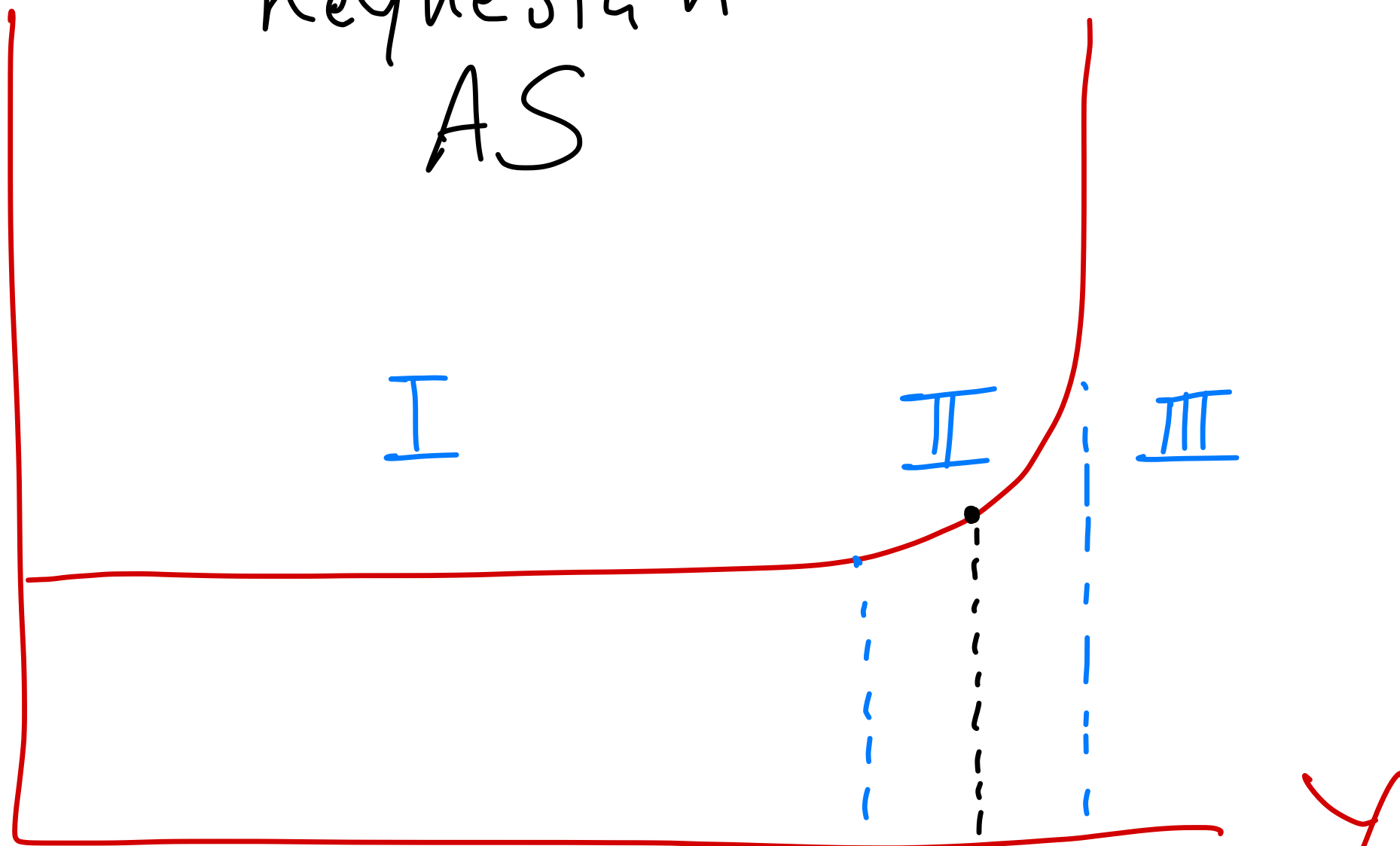
- longer unemployment
- economy is in recession for a long time
- sticky wage & price

Keynesian

- ① market is not perfect nor self-correcting
due to price & wage rigidities
- ② in SR, price & wage are "downward" inflexible.
- ③ "in the LR, we are all dead". (Keynes, 1923)
- ④ due to price & wage rigidities, economy may
stuck in SR or deflationary gap for a long time.
- ⑤ govt may need to intervene. demand-side
policy may be required for economy to reach Y_F .

P

Keynesian
AS



Y_F Y_{max}

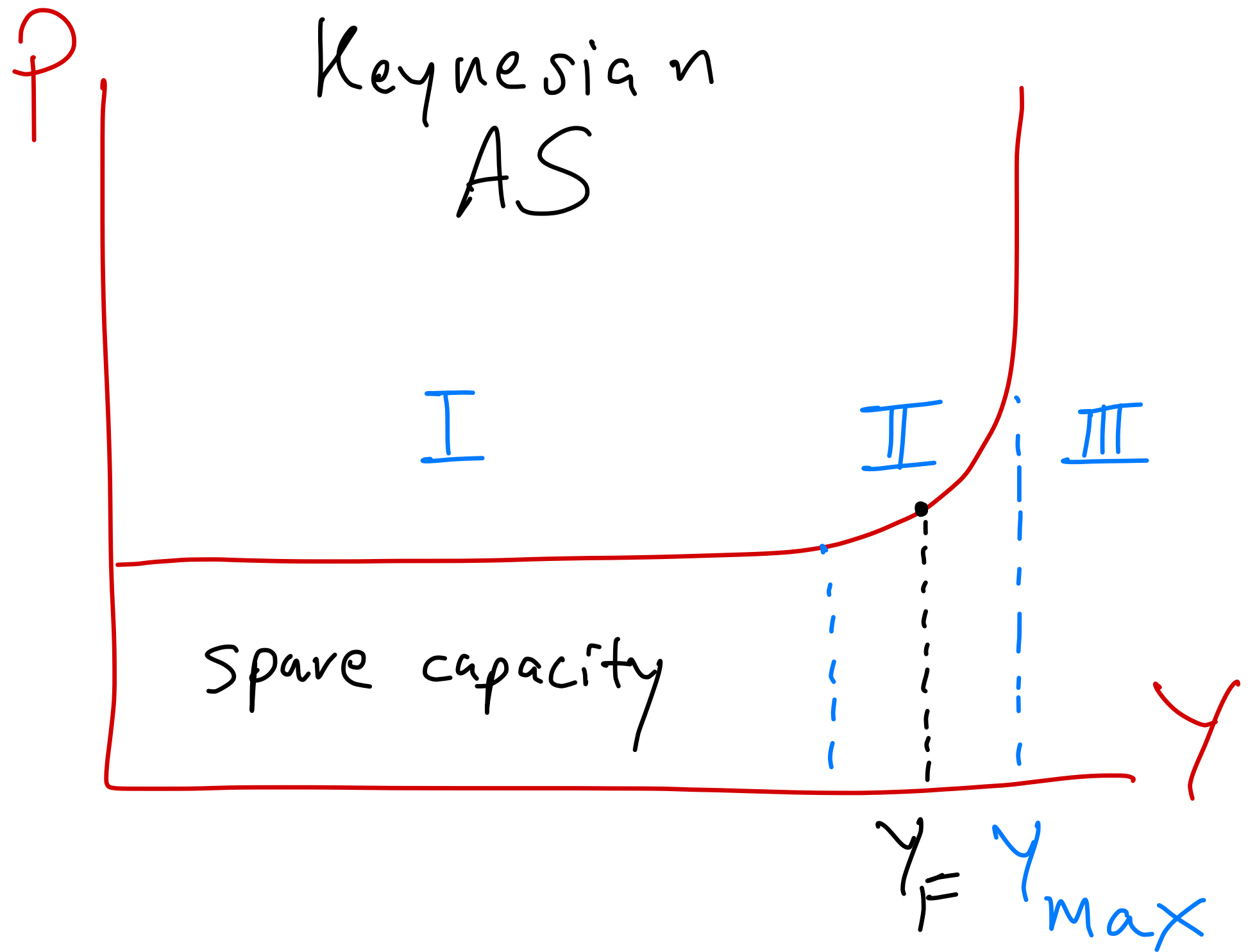
$U = U_N$

$U = 0$

In Section (I),
economy has
spare capacity
(unused resources).

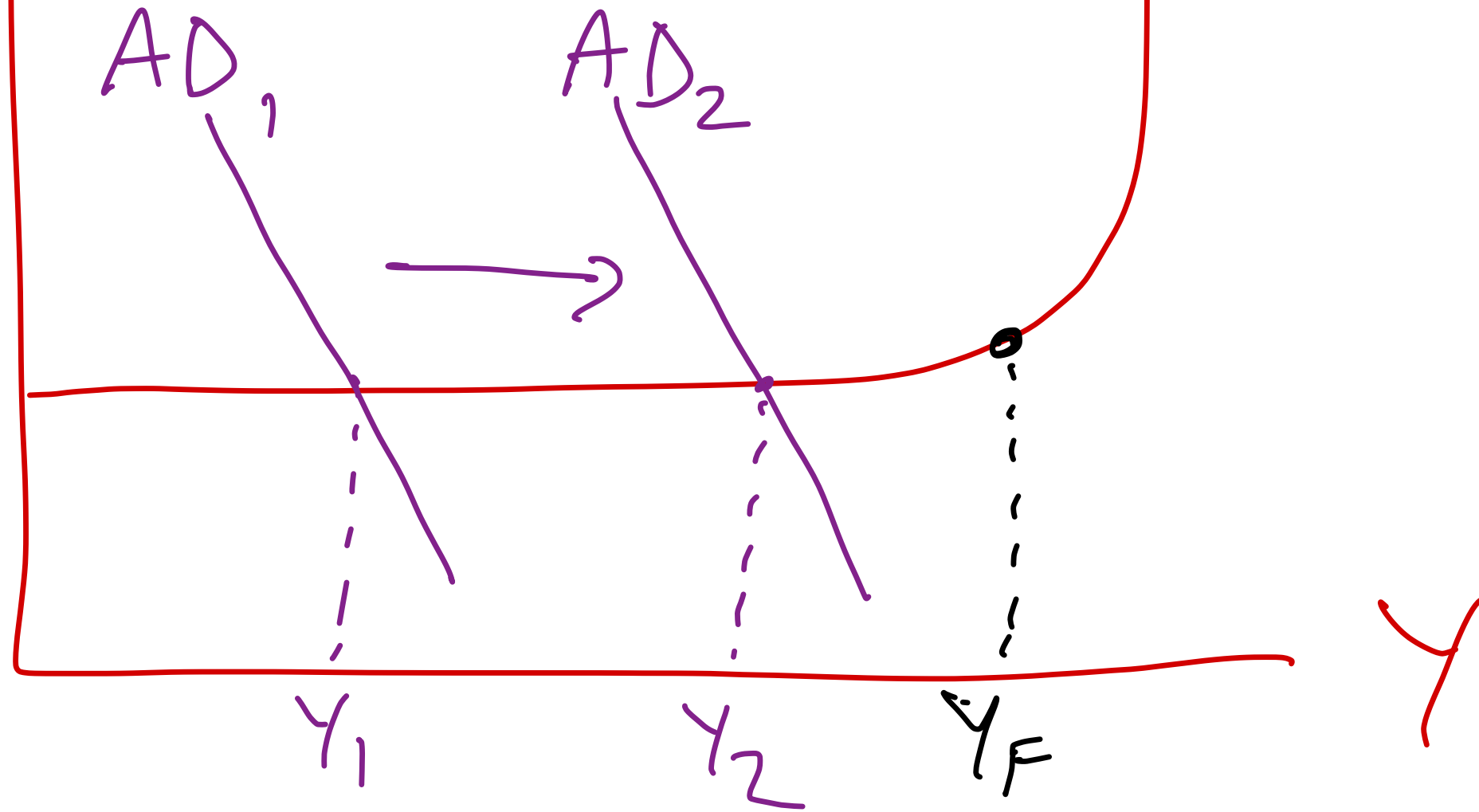
In Section (II),
spare capacity
runs out.

In Section (III),
all resources are used.



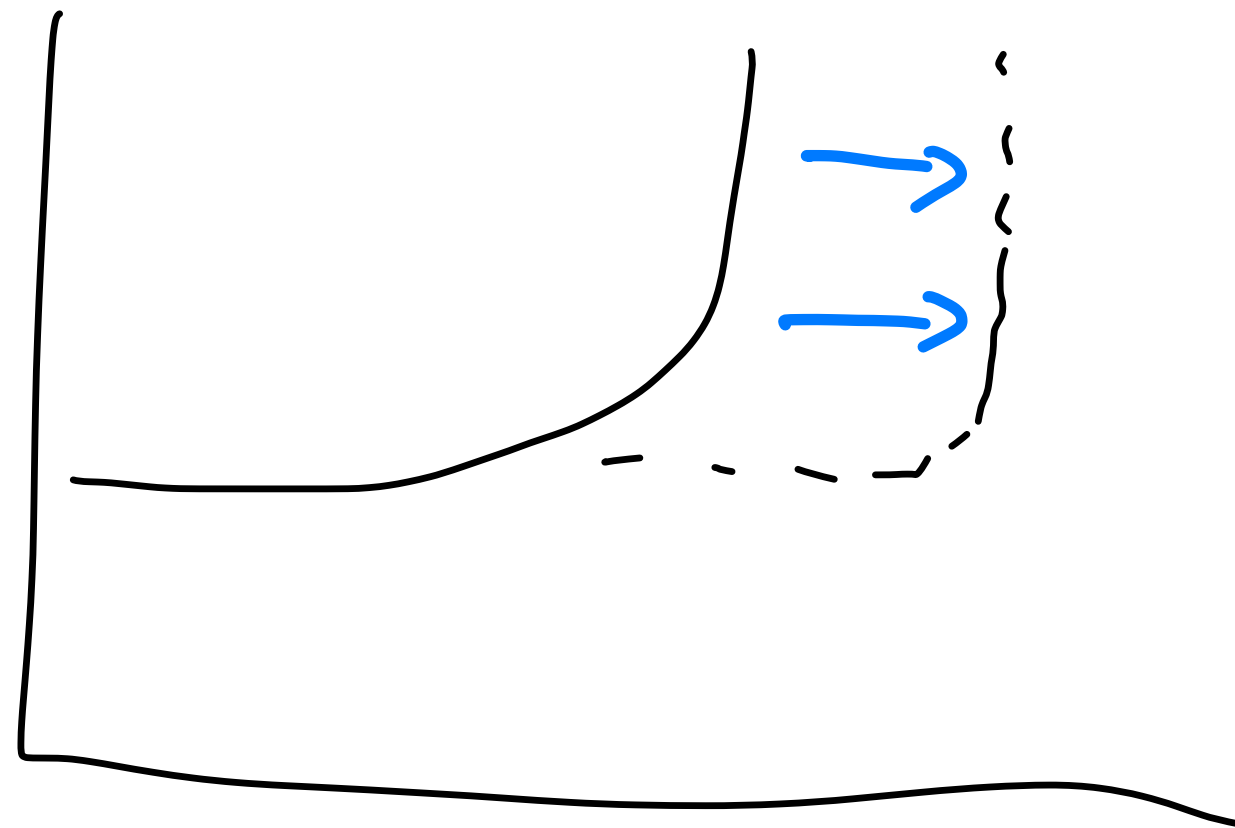
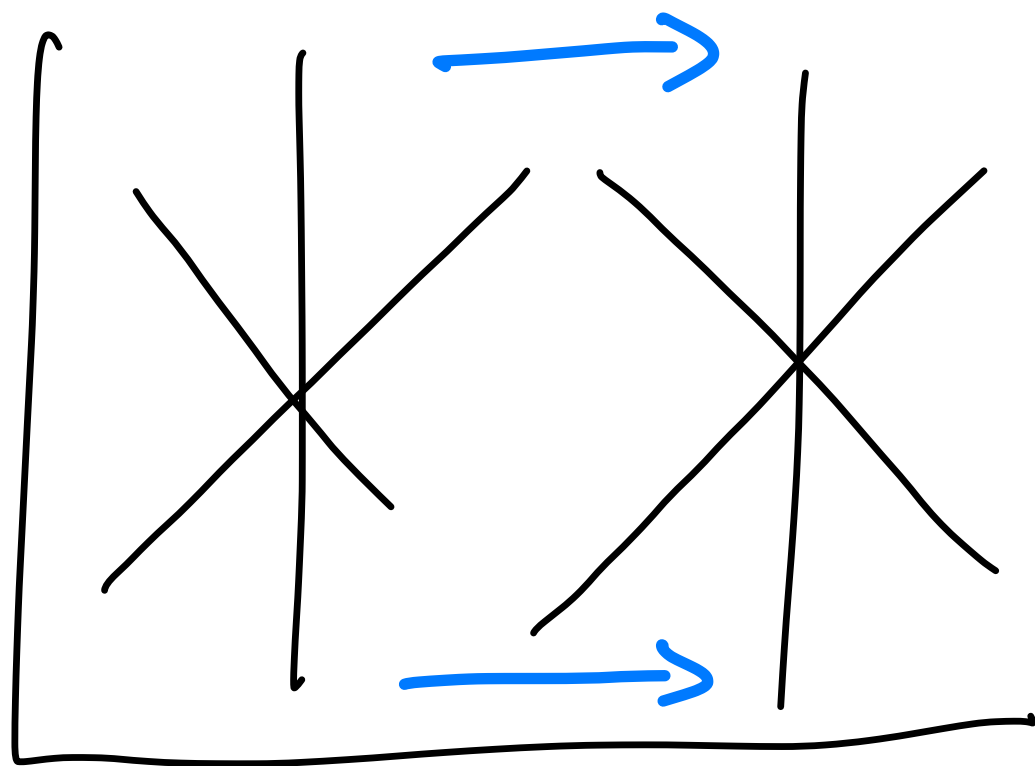
P

Keynesian AS



★ Demand-side policy is necessary ★
for moving economy towards Y_F .

LR Growth



govt should use

"Supply - side policy"

- education

- infrastructure

Phillips Curve (PC)


- a concept that unemployment (u) and inflation (π) have an inverse relationship.

• $\pi \uparrow \rightarrow u \downarrow$ or $u \uparrow \rightarrow \pi \downarrow$

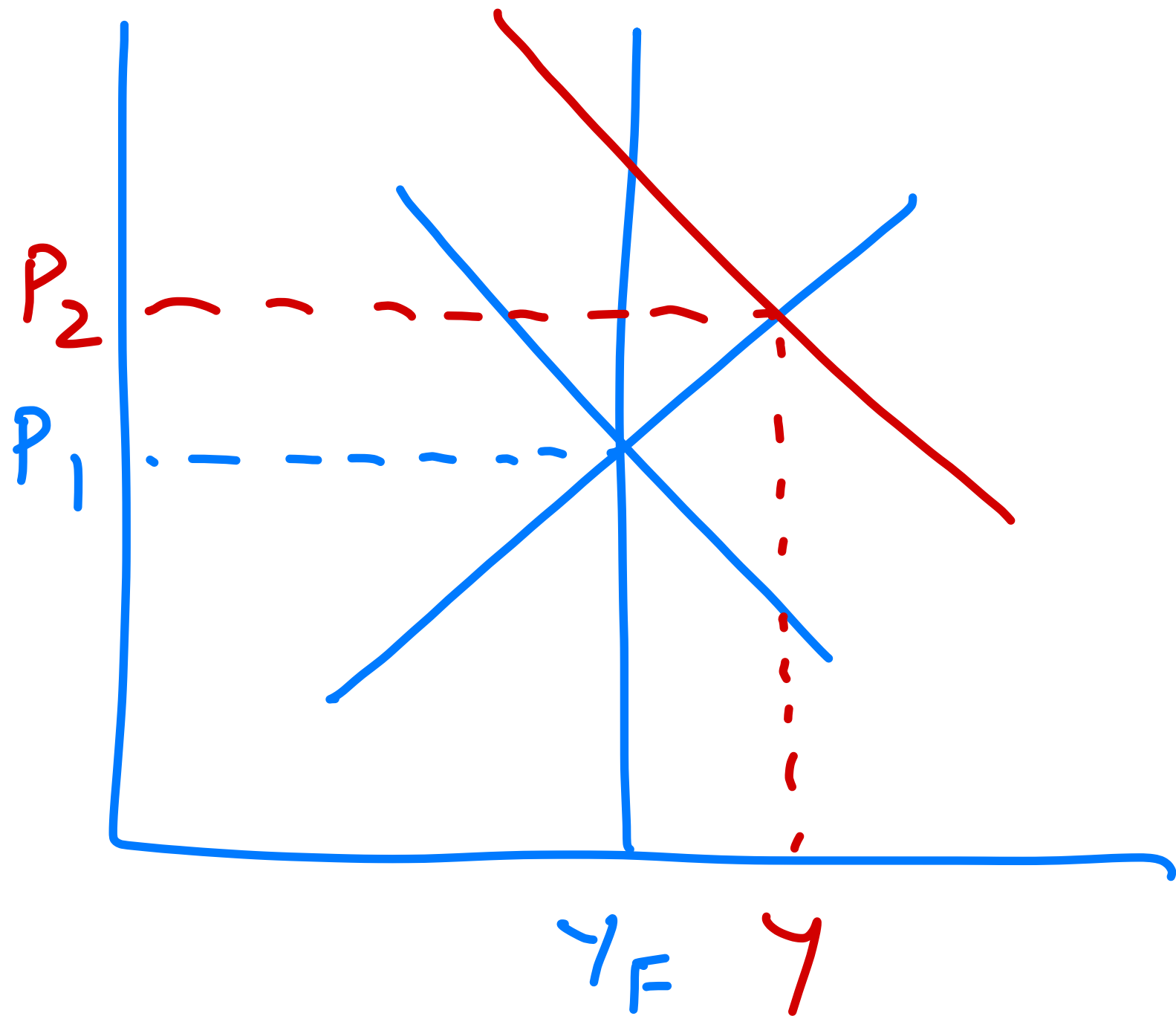
Logic : economic growth \rightarrow inflation
 \hookrightarrow more jobs \rightarrow less unemployment

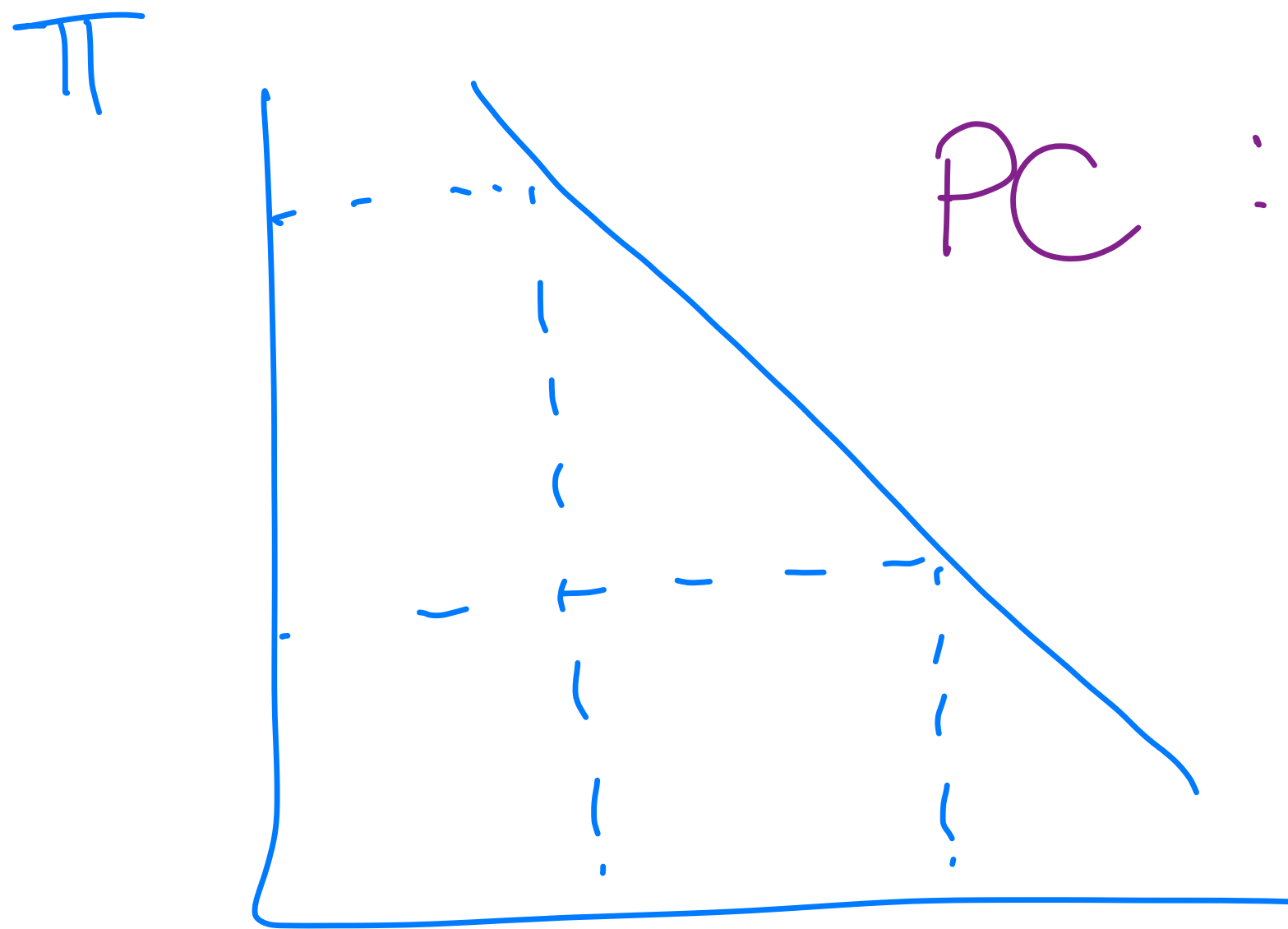
Problem : Policy Makers face "trade-off"
b/w u & π .

3 macro goals

- output growth
 - low unemployment → high π
 - low inflation
- trade off
- 

$Y \uparrow \rightarrow P \uparrow$
 $\rightarrow U \downarrow$ } trade off





PC : negative relationship

π & u

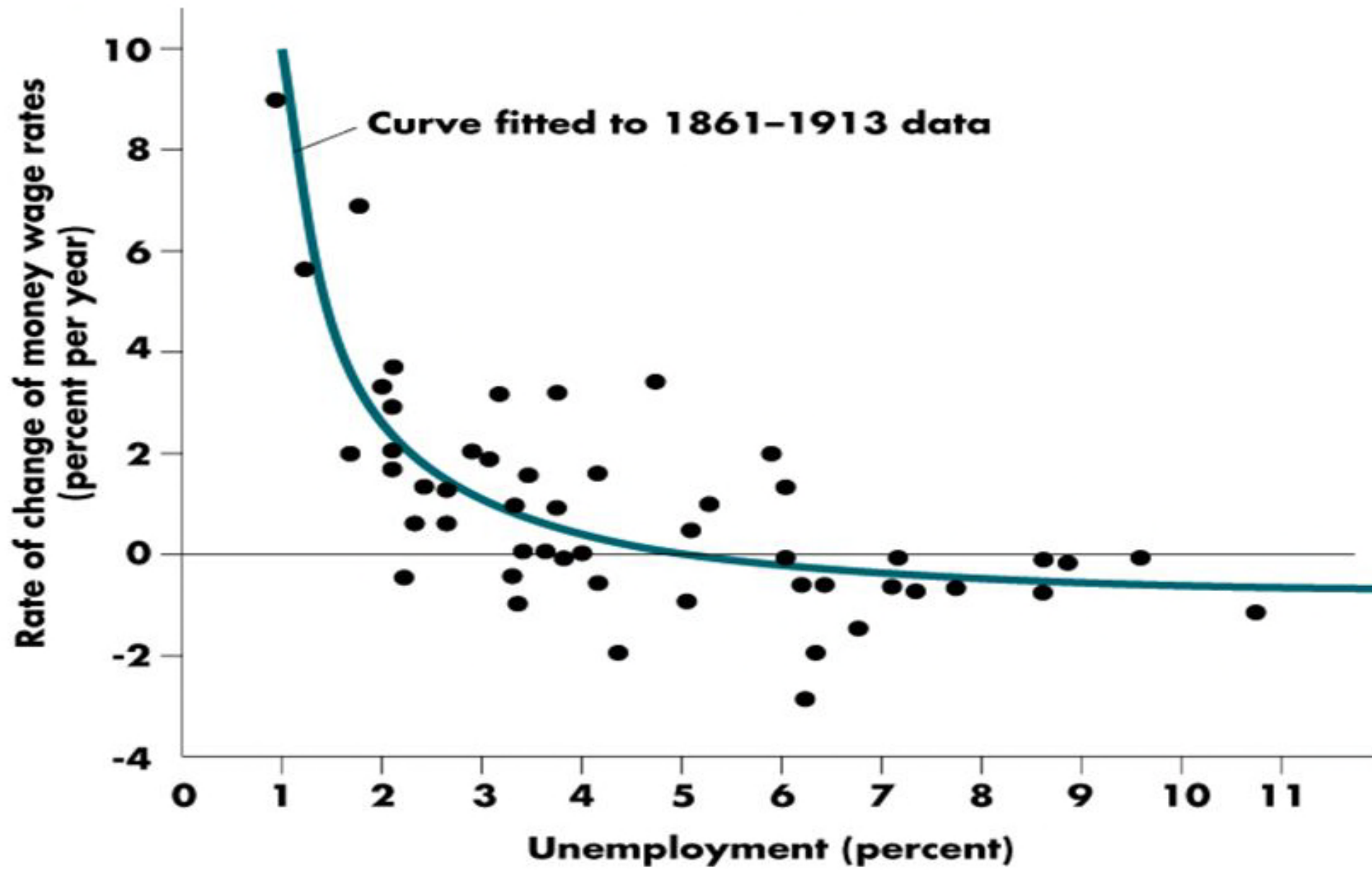
u

★ PC fails during "stagflation" ★

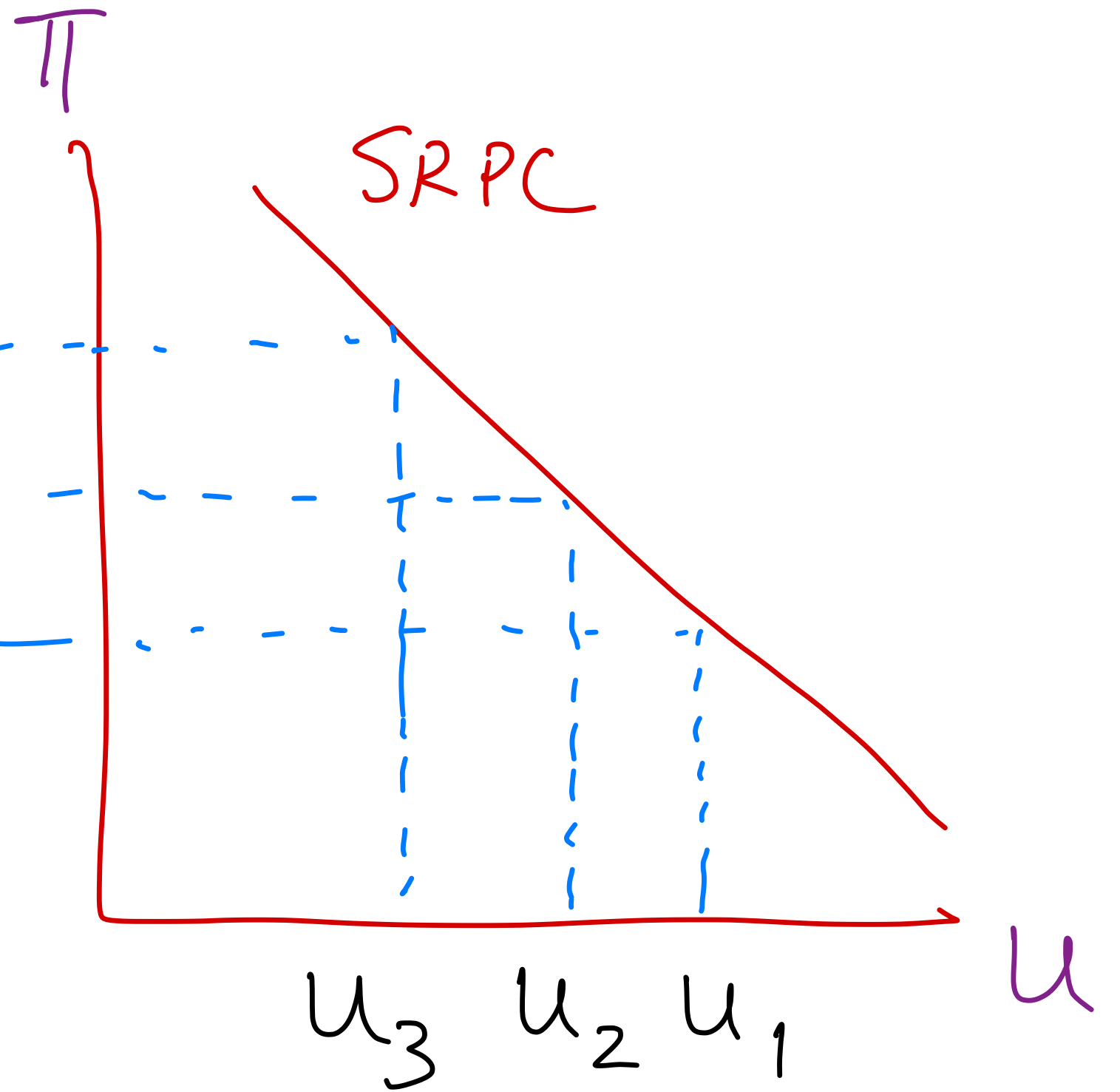
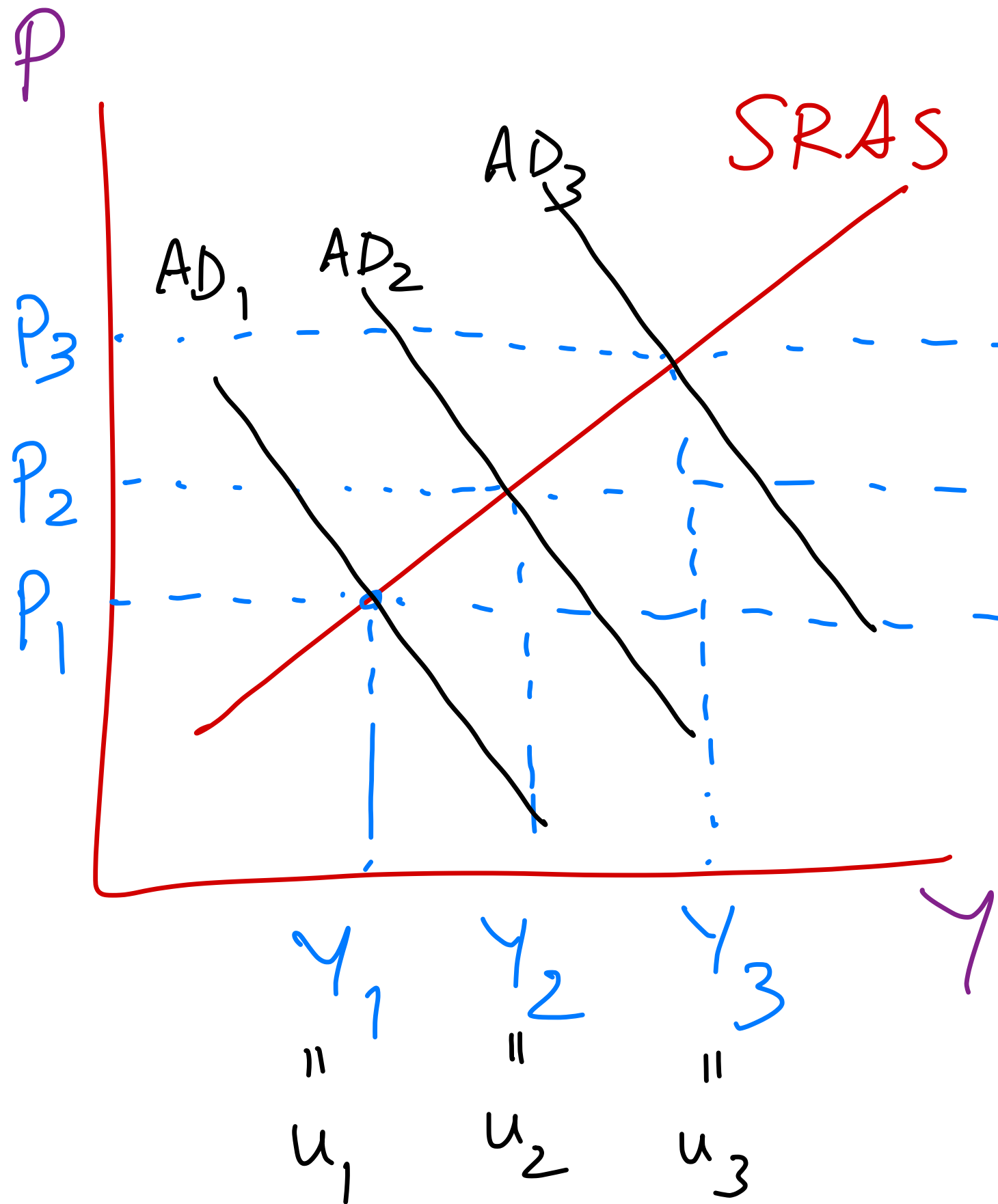
★ Economists argue that PC is ★

a SR phenomenon, not a LR one.

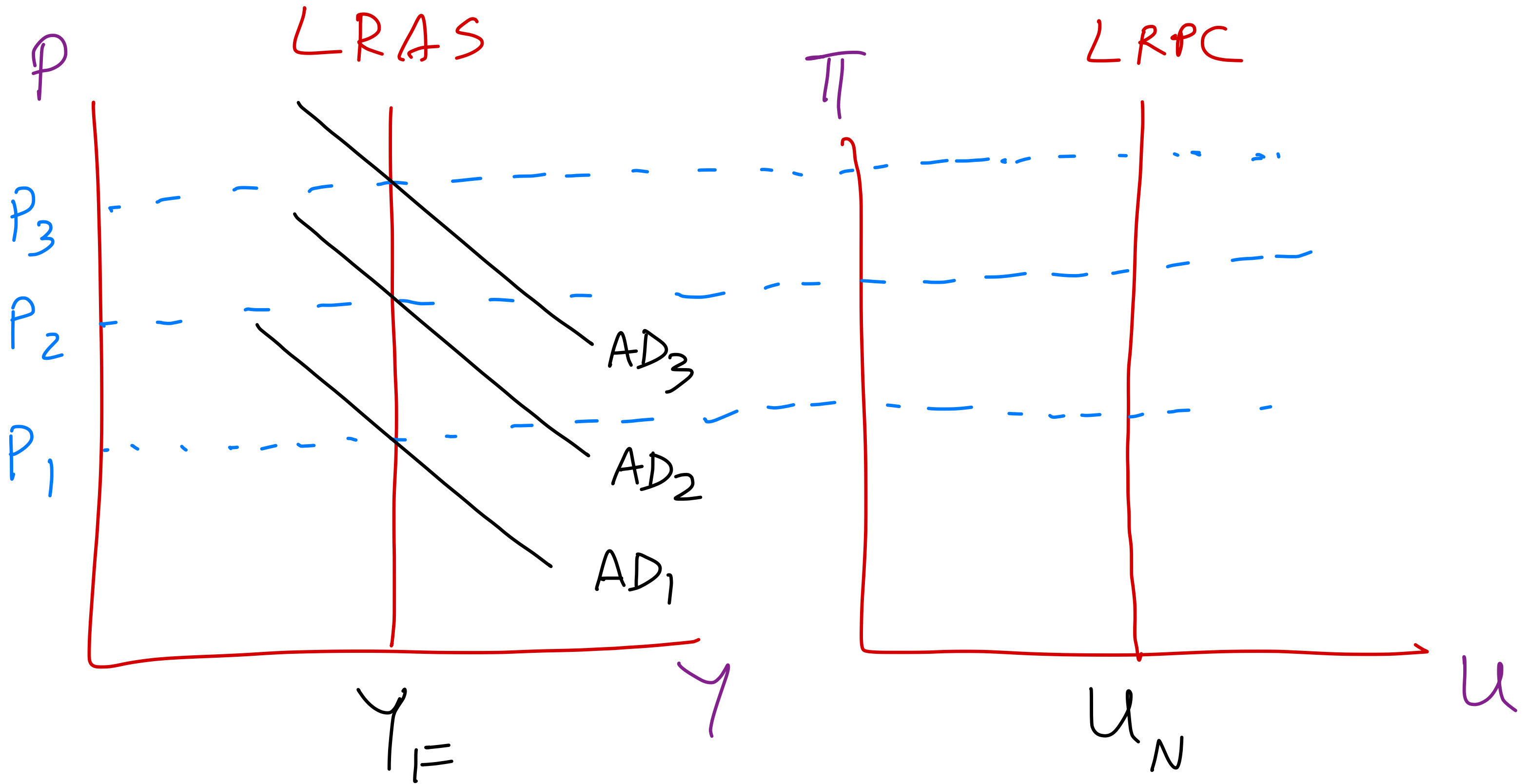
The Original Phillips Curve for the United Kingdom



SRPC



LRPC



THANK

YOU