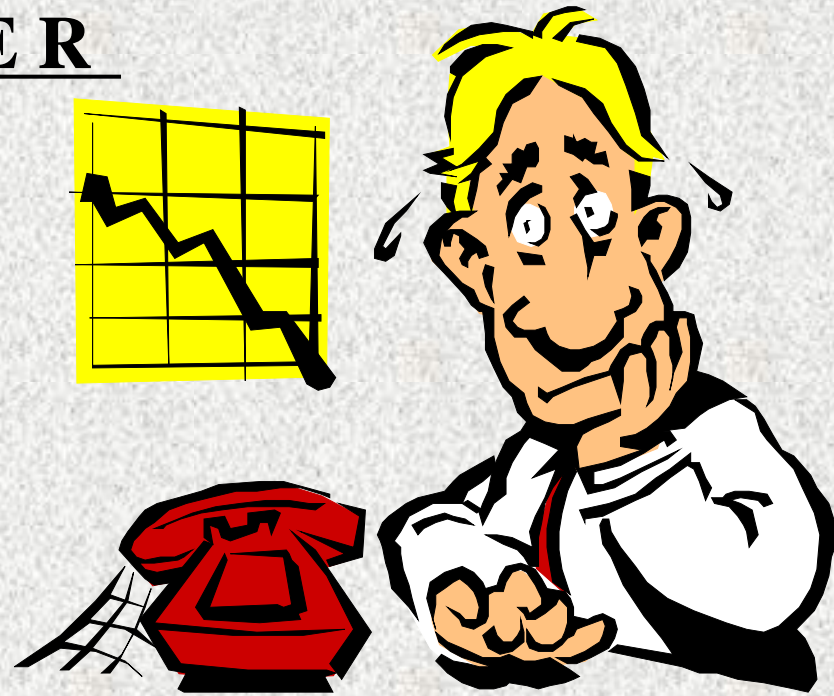


# 15

CHAPTER

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## *Extending the Analysis of Aggregate Supply*

# SHORT-RUN AND LONG-RUN AGGREGATE SUPPLY

## *Short Run -*

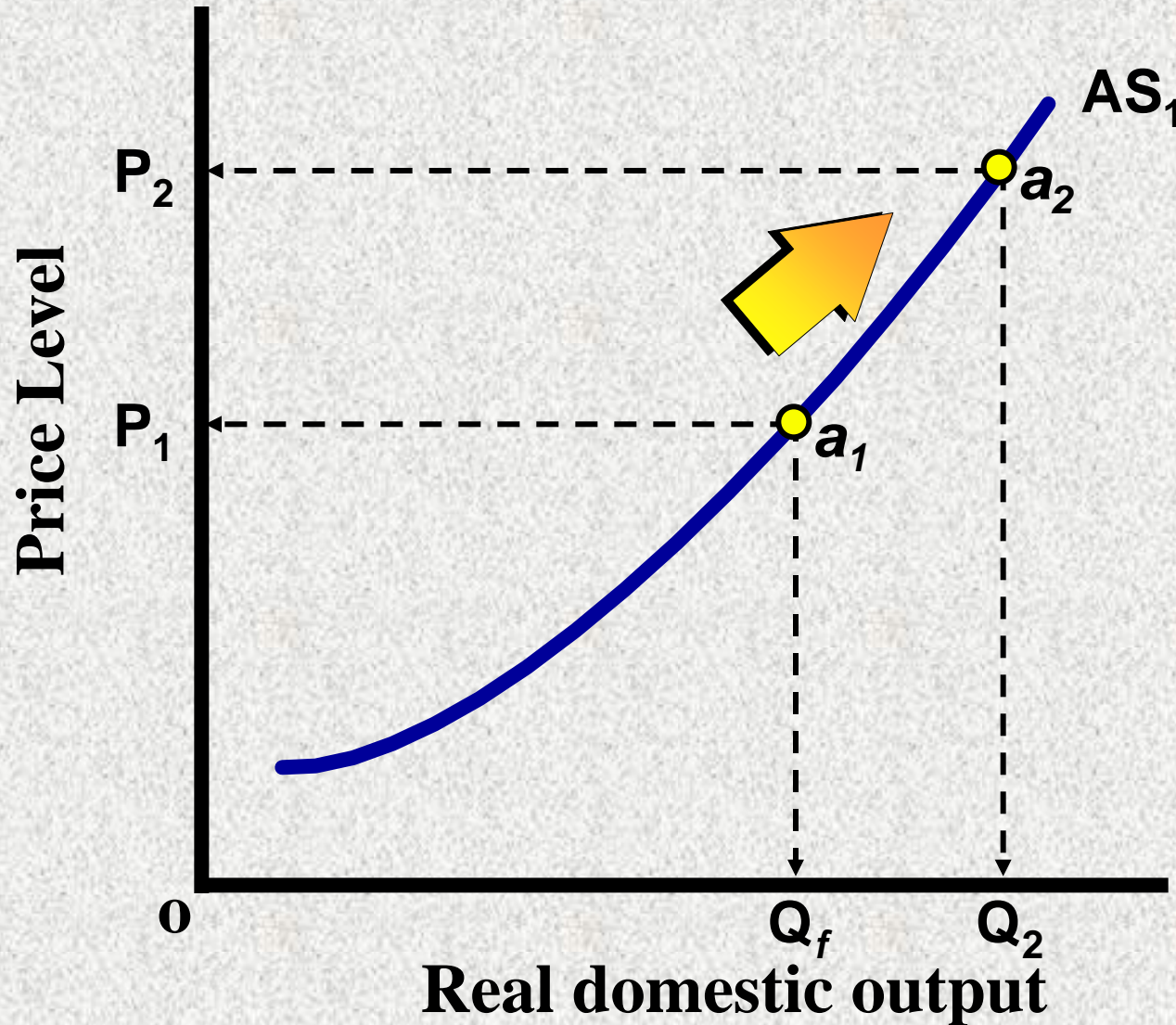
Period in which nominal wages (and other input prices) remain fixed as the price level increases or decreases

## *Long Run -*

Period in which nominal wages are fully responsive to previous changes in the price level

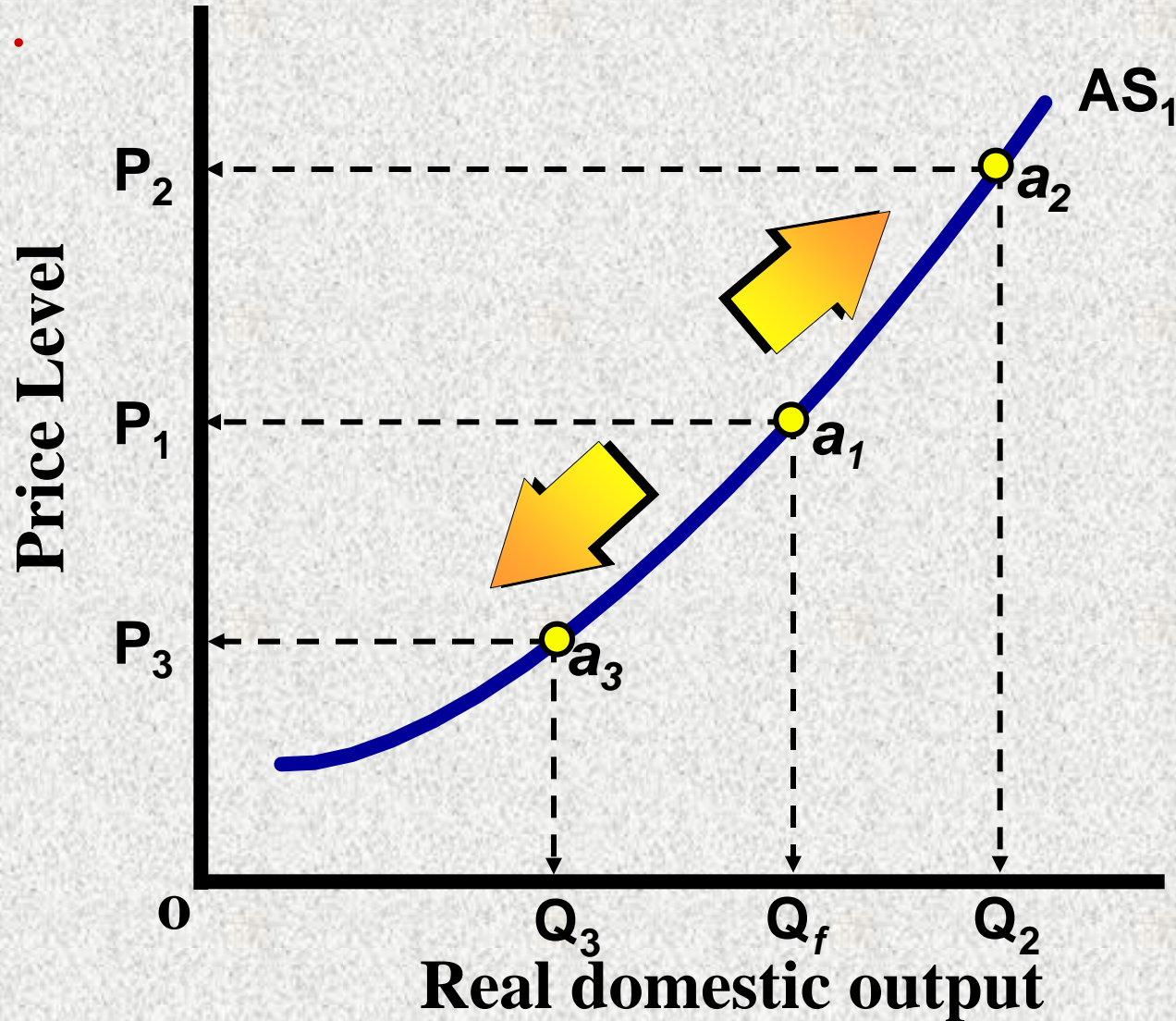
# SHORT-RUN AGGREGATE SUPPLY

*A higher price level increases profits and output moving the economy from  $a_1$  to  $a_2$ .*



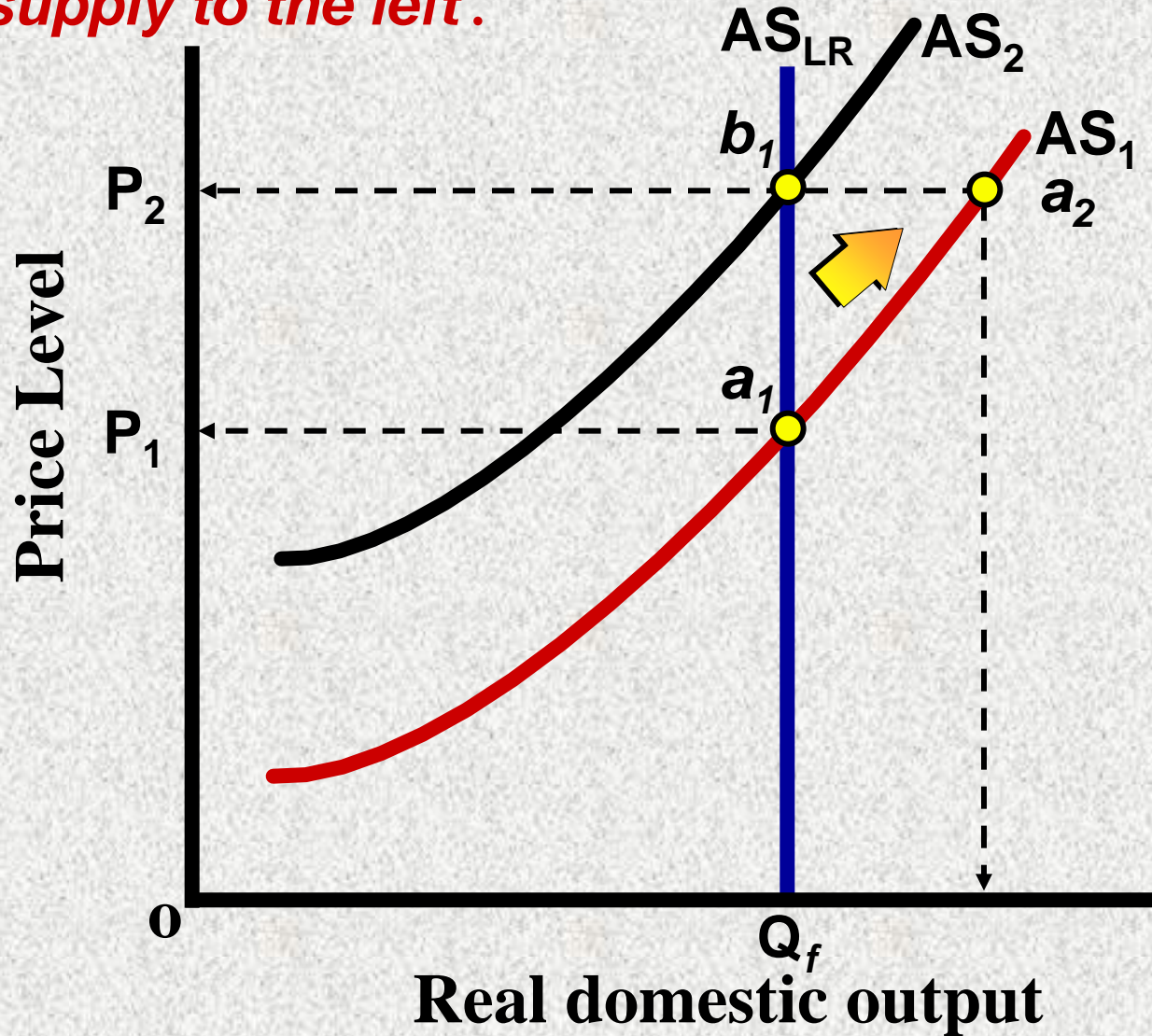
# SHORT-RUN AGGREGATE SUPPLY

*A lower price level decreases profits and output moving the economy from  $a_1$  to  $a_3$*



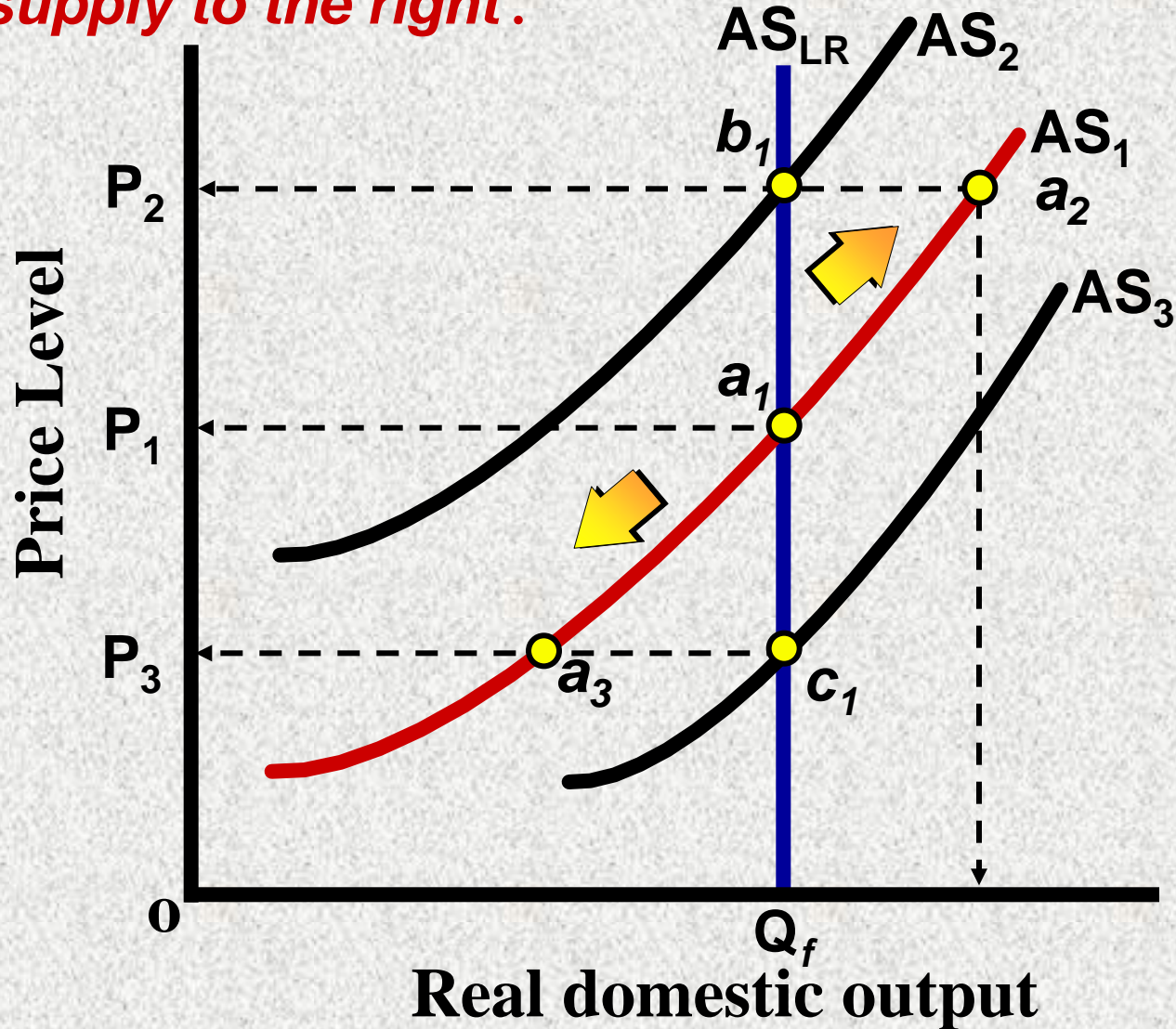
# LONG-RUN AGGREGATE SUPPLY

*A higher price level results in higher nominal wages and thus shifts the short-run aggregate supply to the left.*

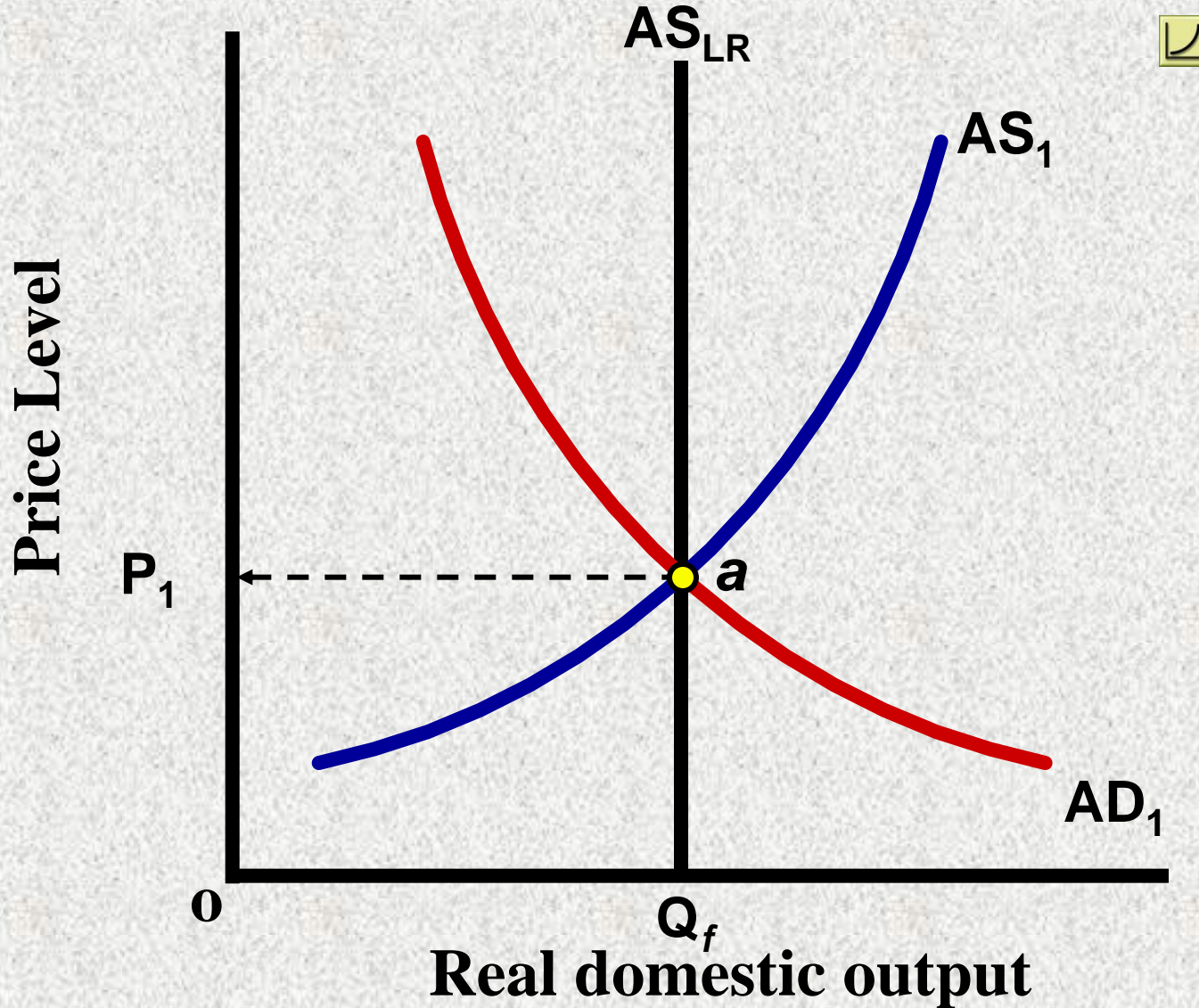


# LONG-RUN AGGREGATE SUPPLY

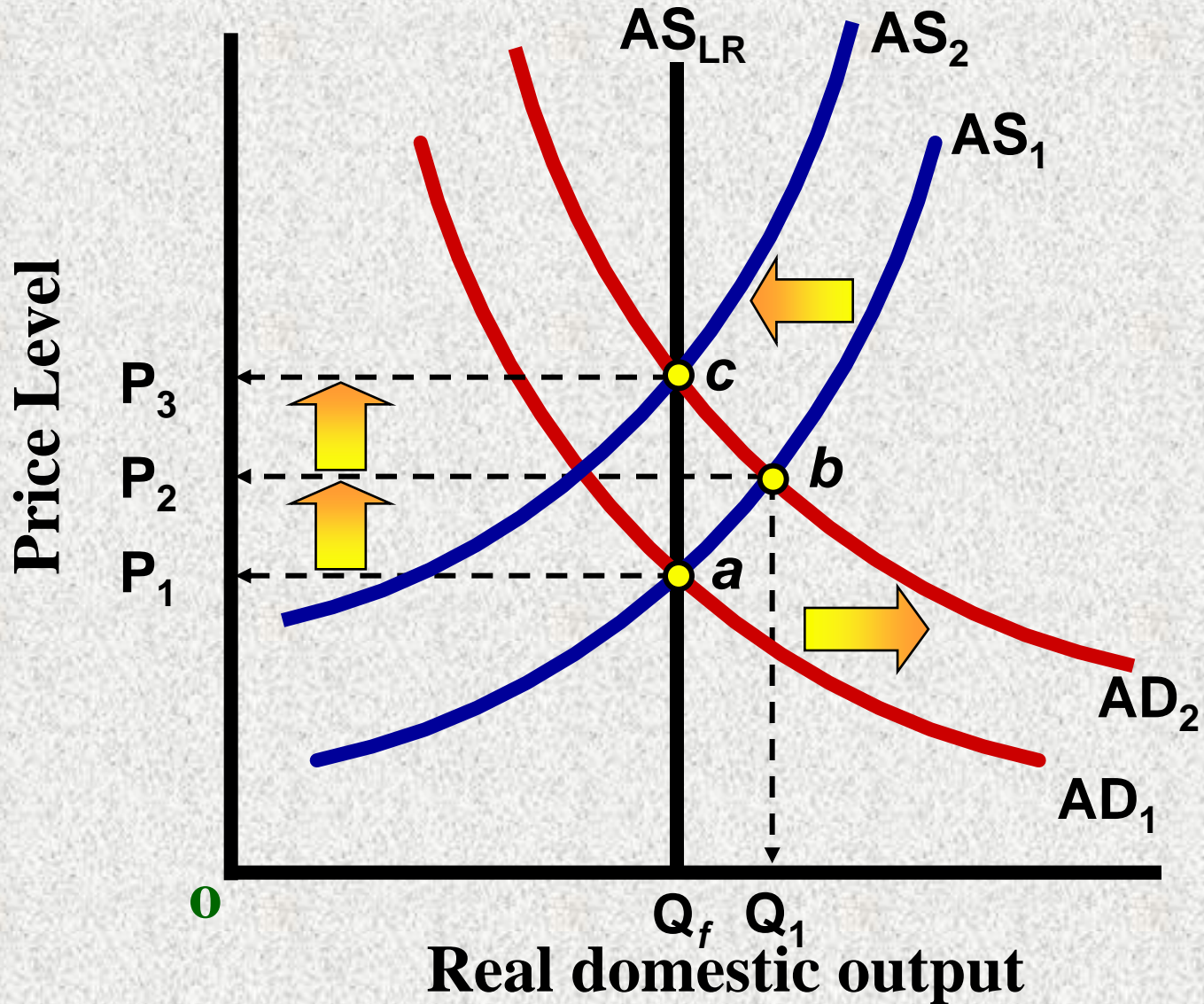
*A lower price level results reduces nominal wages and shifts the short-run aggregate supply to the right.*



# EQUILIBRIUM IN THE EXTENDED AD-AS MODEL



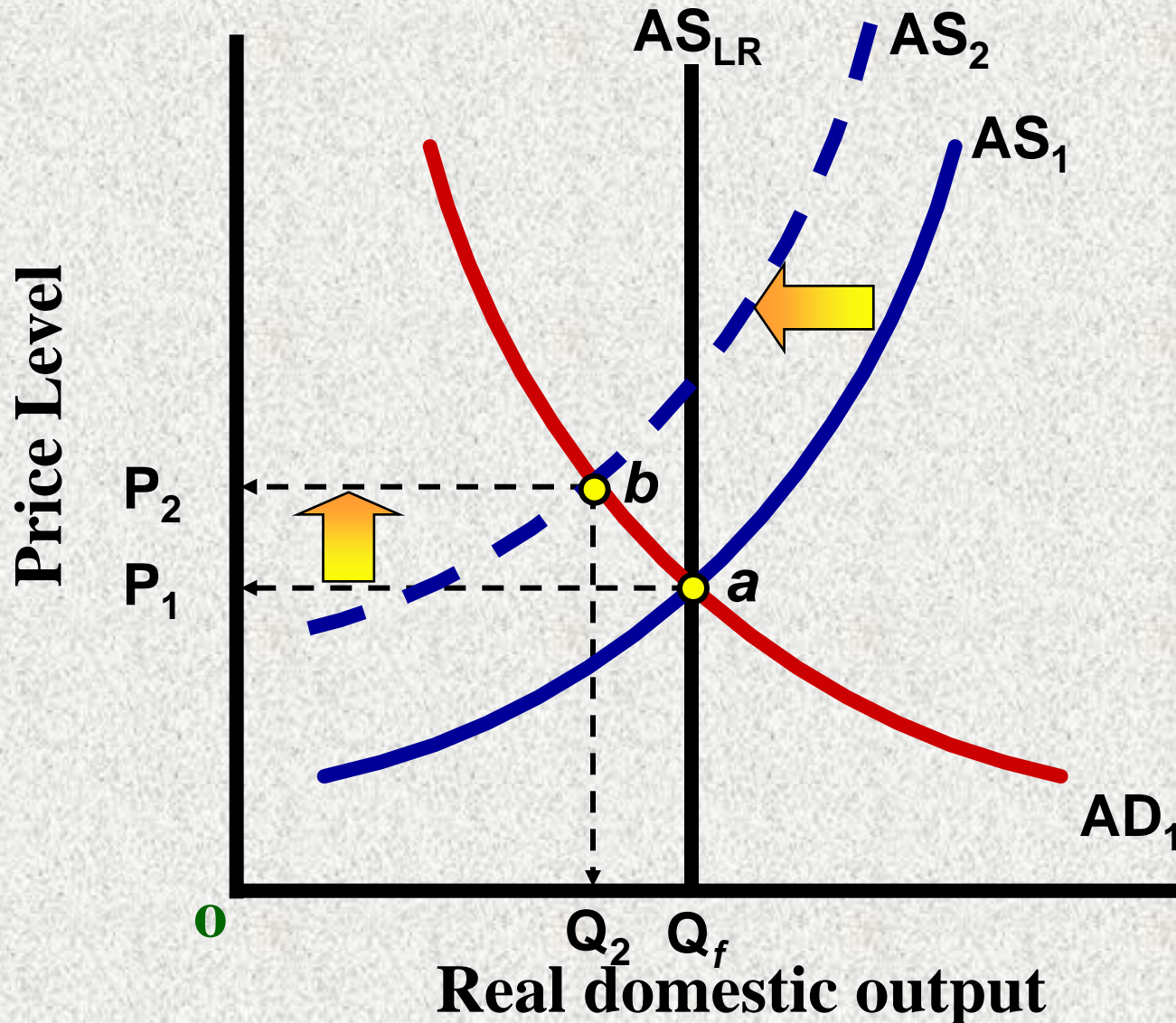
# DEMAND-PULL INFLATION





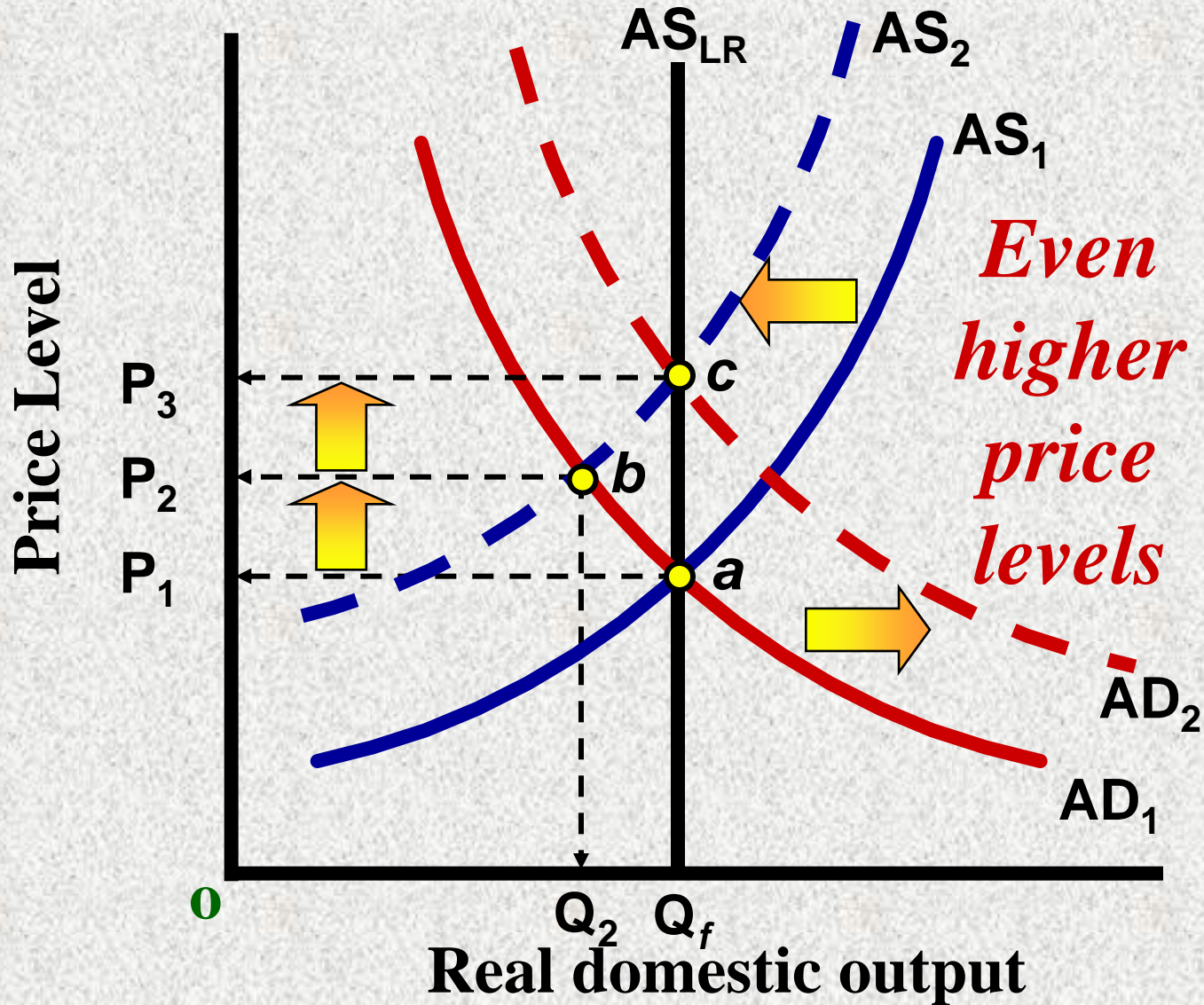
# COST-PUSH INFLATION

*Occurs when short-run AS shifts left*



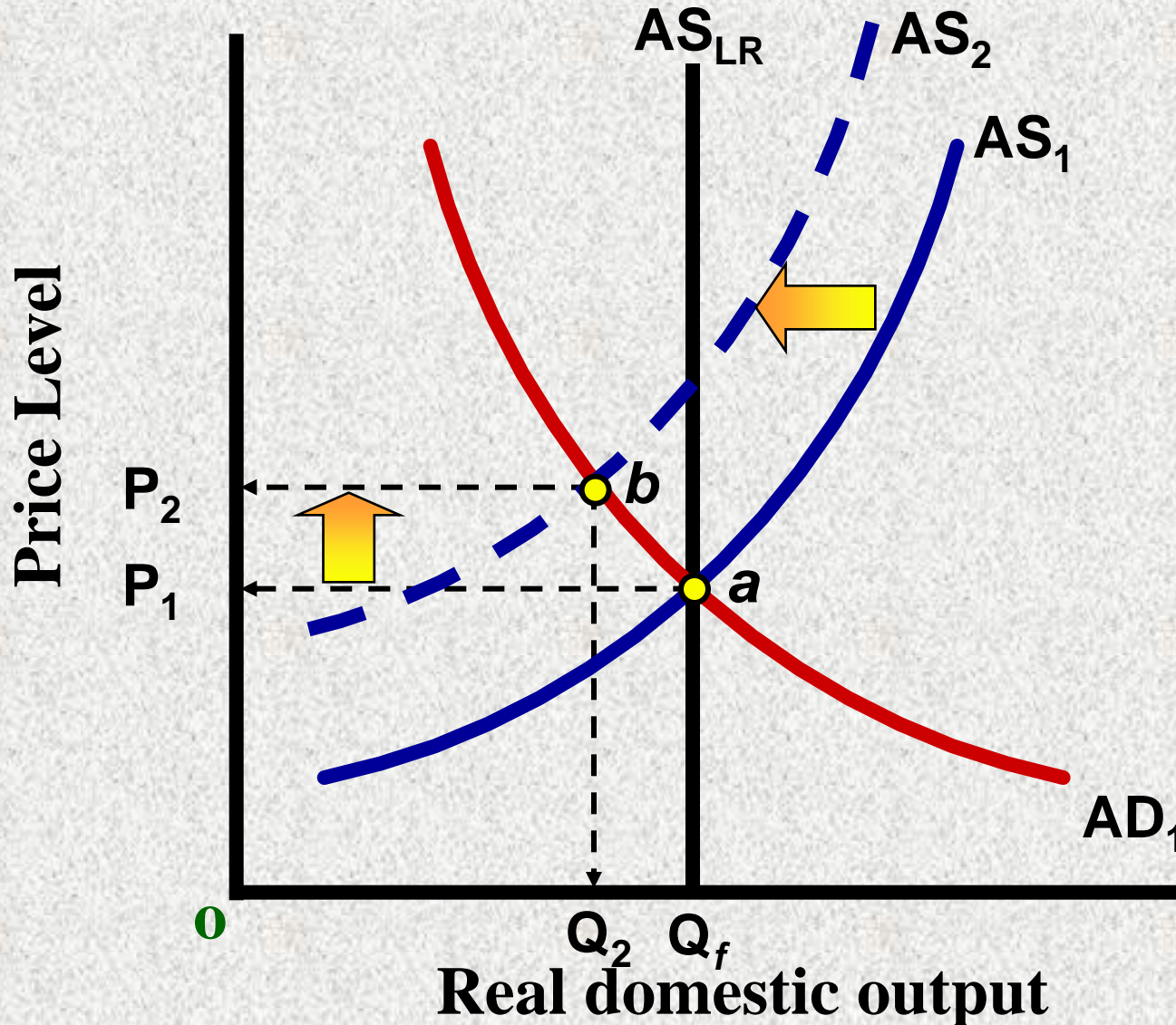
# COST-PUSH INFLATION

*Government response with increased AD*



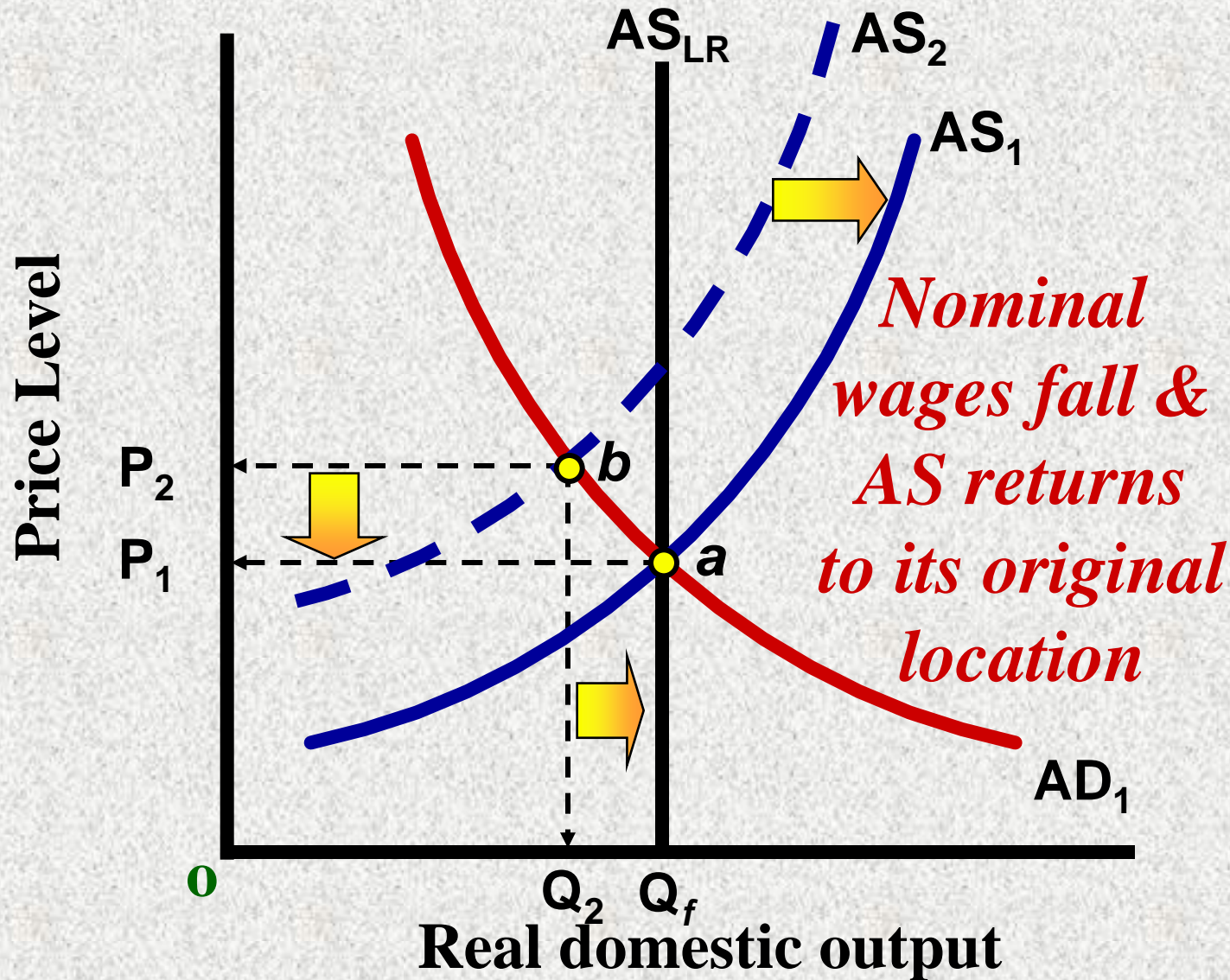
# COST-PUSH INFLATION

*If government allows a recession to occur*



# COST-PUSH INFLATION

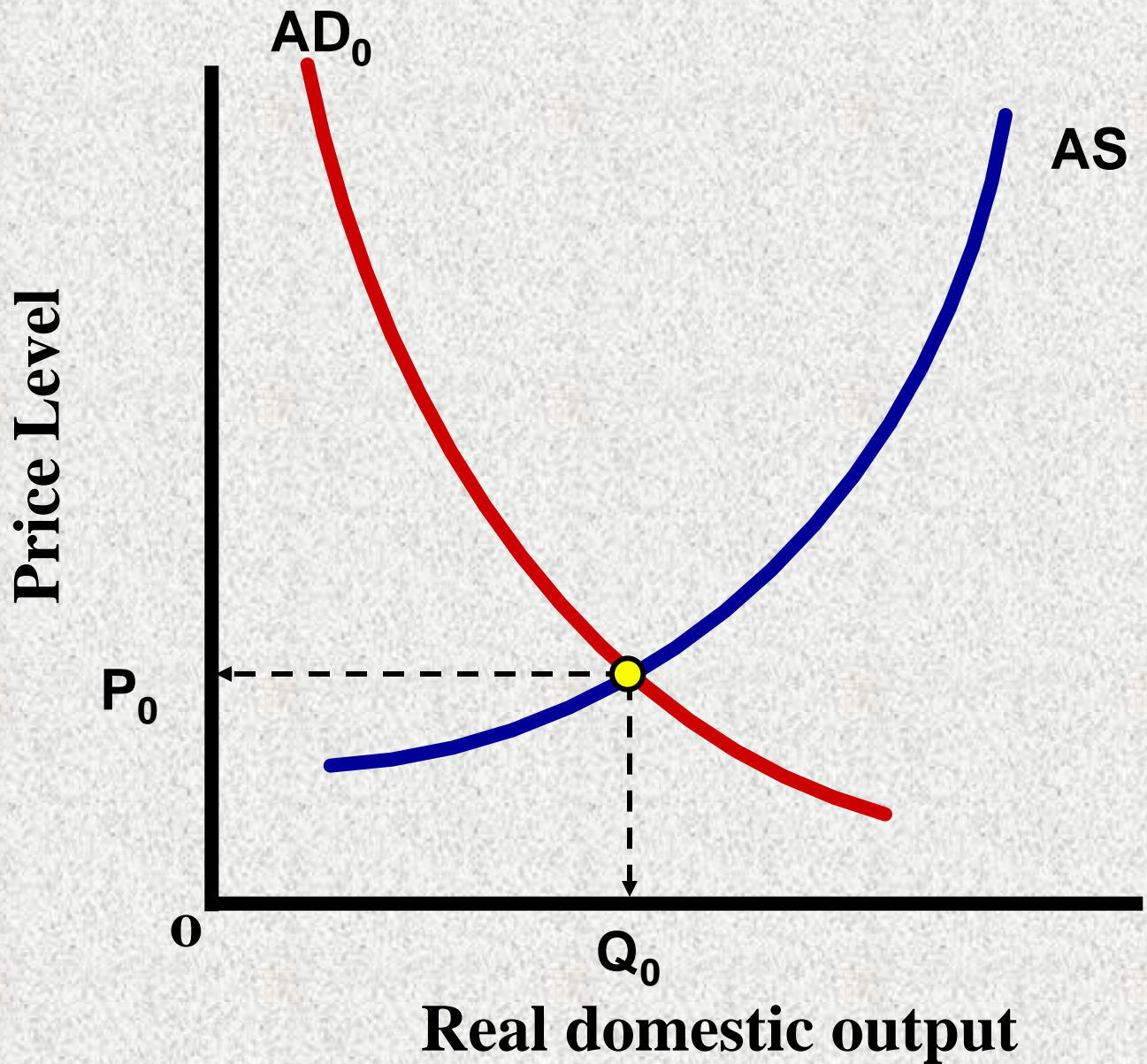
*If government allows a recession to occur*



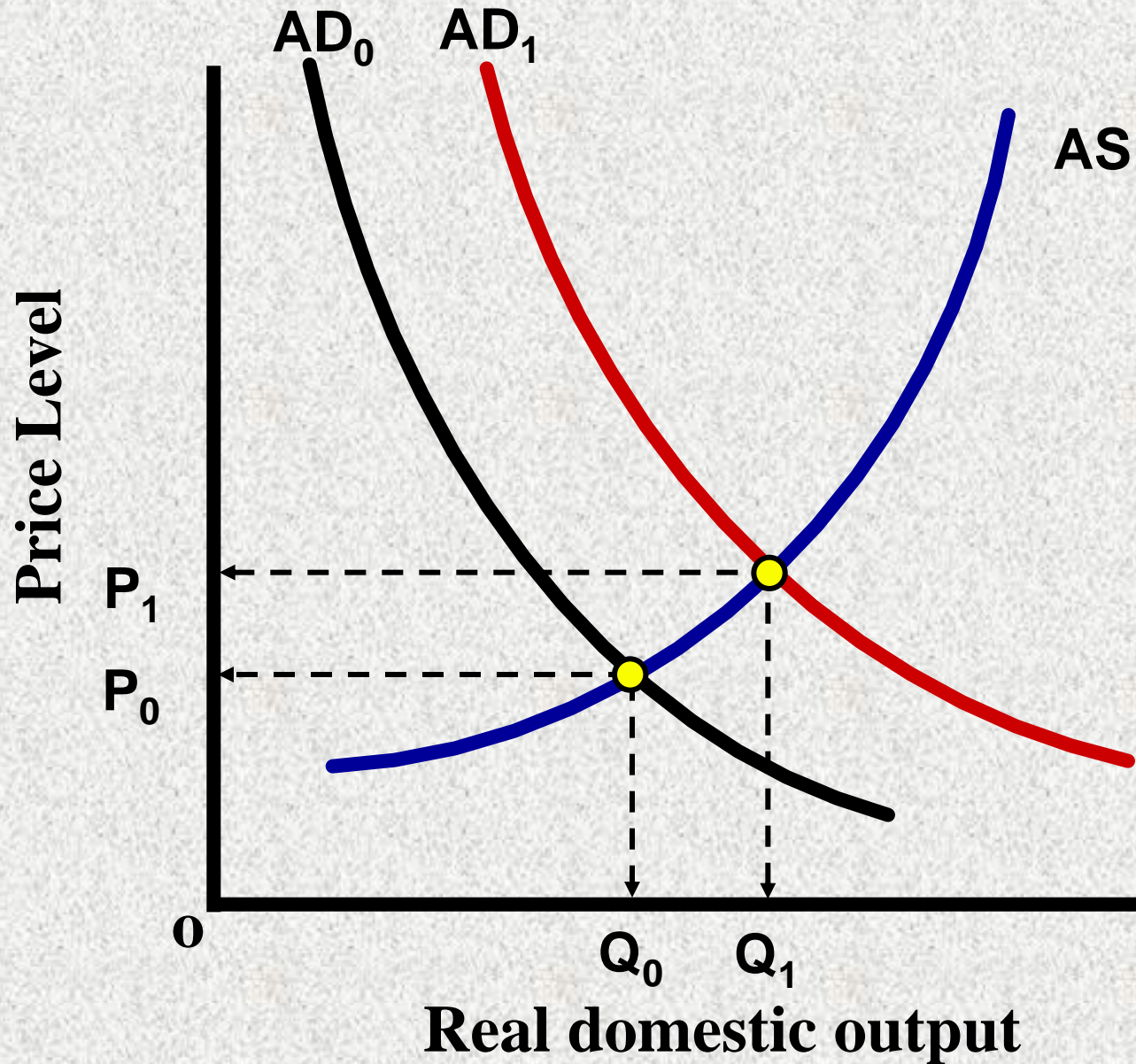
# **THE INFLATION-UNEMPLOYMENT RELATIONSHIP**

- **Normally, there is a short-run trade-off between the rate of inflation and the the rate of unemployment.**
- **Aggregate supply shocks can cause both higher rates of inflation and higher rates of unemployment.**
- **There is no significant trade-off over long periods of time.**

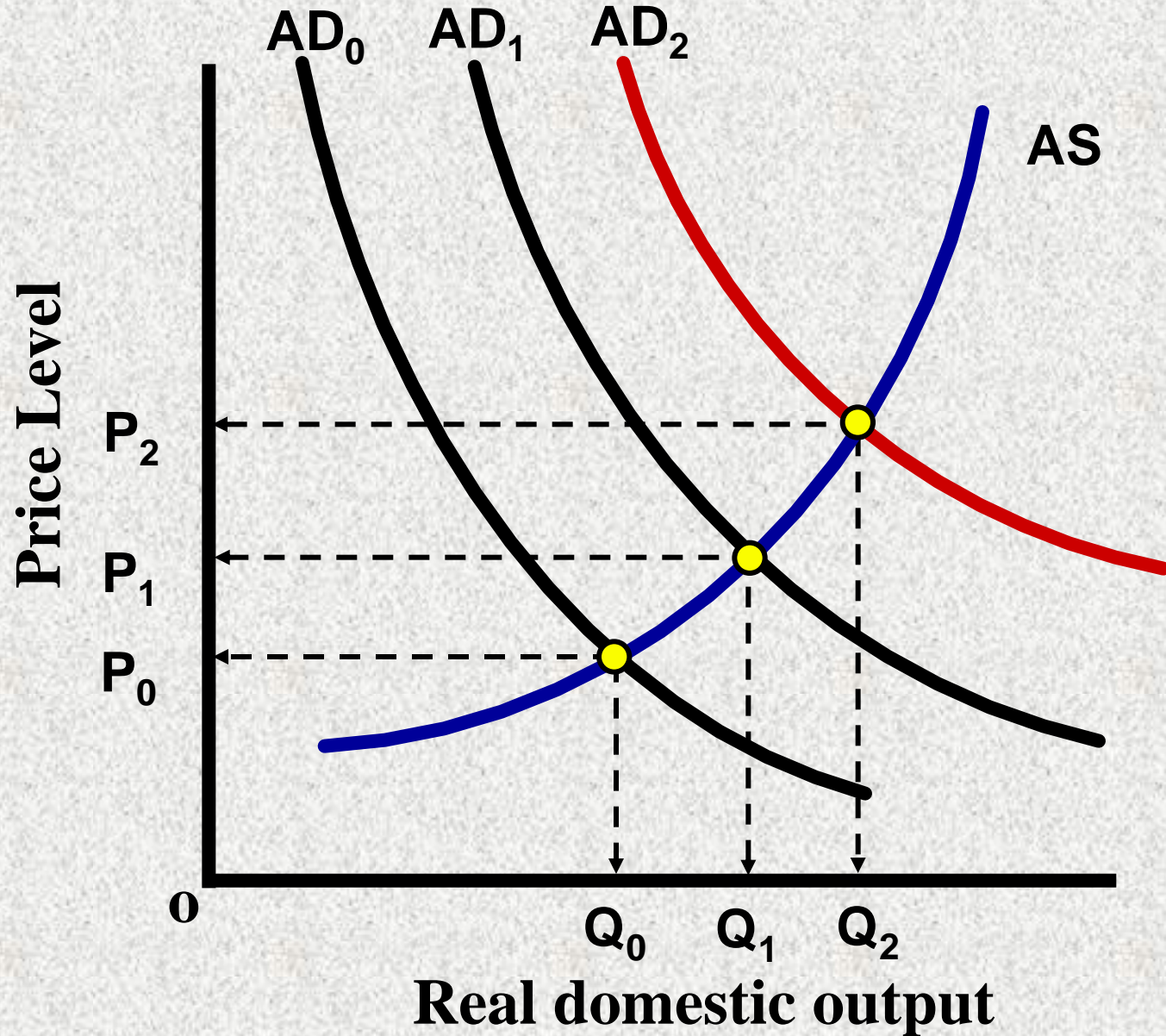
# EFFECT OF CHANGES IN AGGREGATE DEMAND ON REAL OUTPUT AND THE PRICE LEVEL



# EFFECT OF CHANGES IN AGGREGATE DEMAND ON REAL OUTPUT AND THE PRICE LEVEL

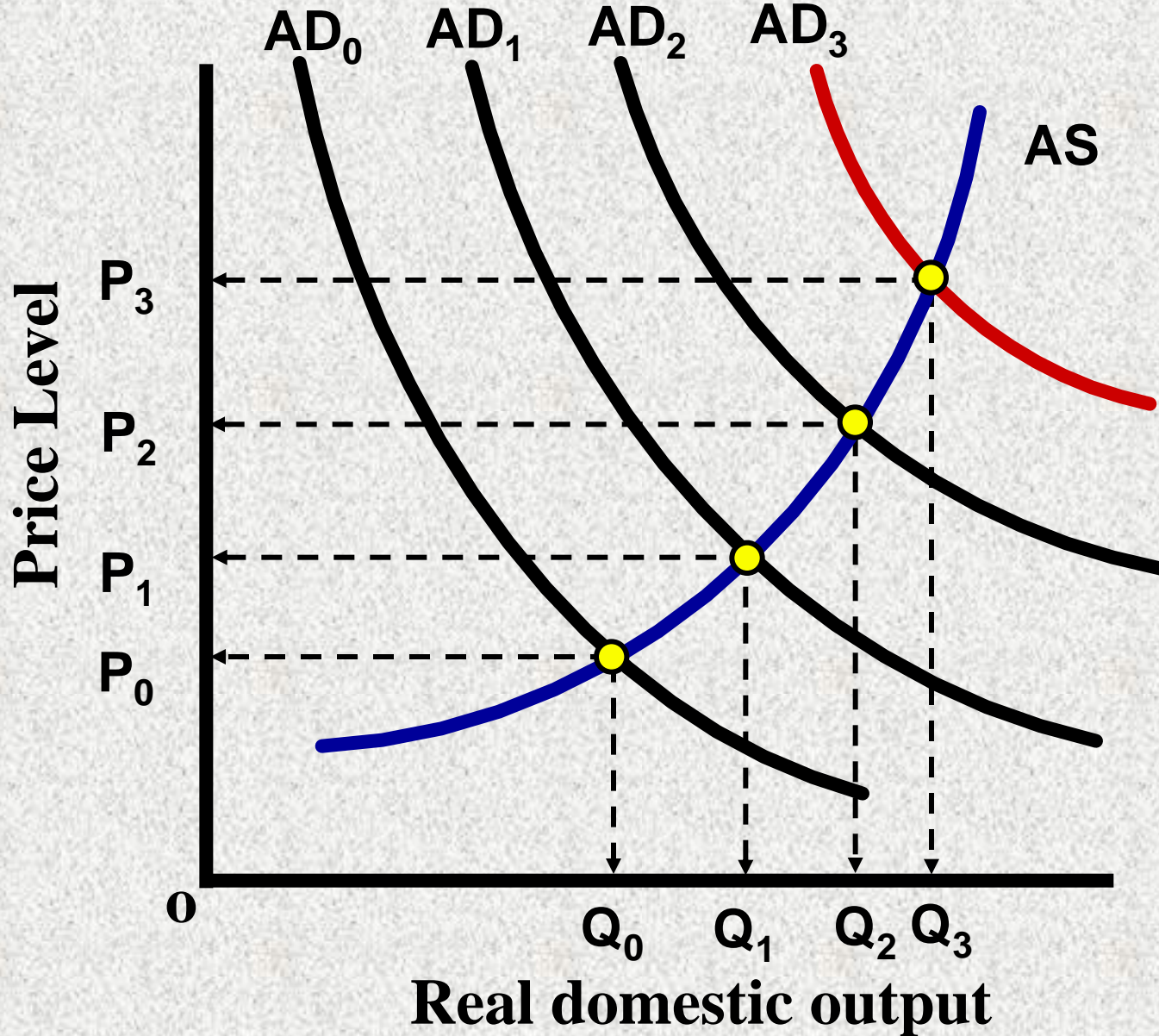


# EFFECT OF CHANGES IN AGGREGATE DEMAND ON REAL OUTPUT AND THE PRICE LEVEL

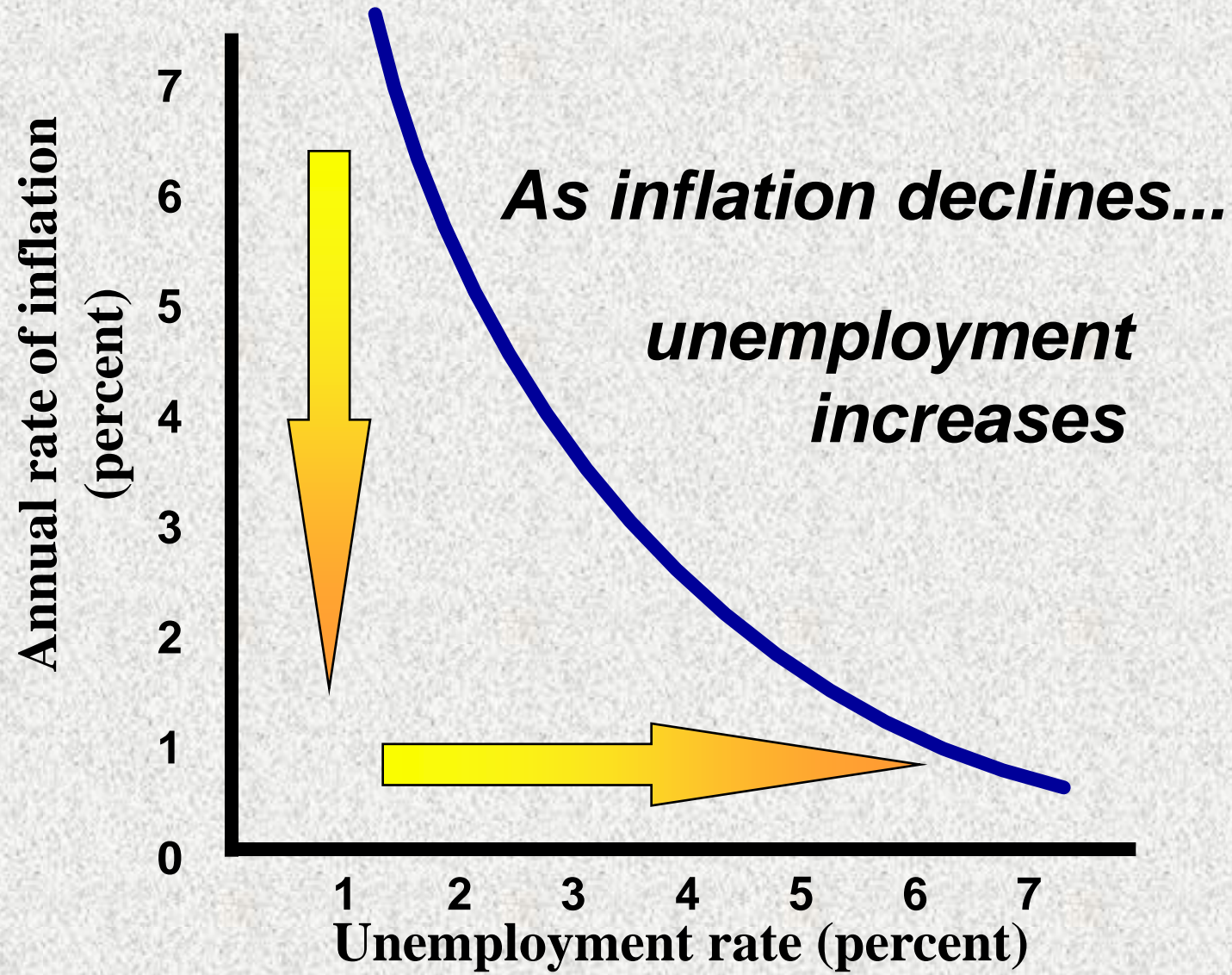




# EFFECT OF CHANGES IN AGGREGATE DEMAND ON REAL OUTPUT AND THE PRICE LEVEL



# THE PHILLIPS CURVE CONCEPT

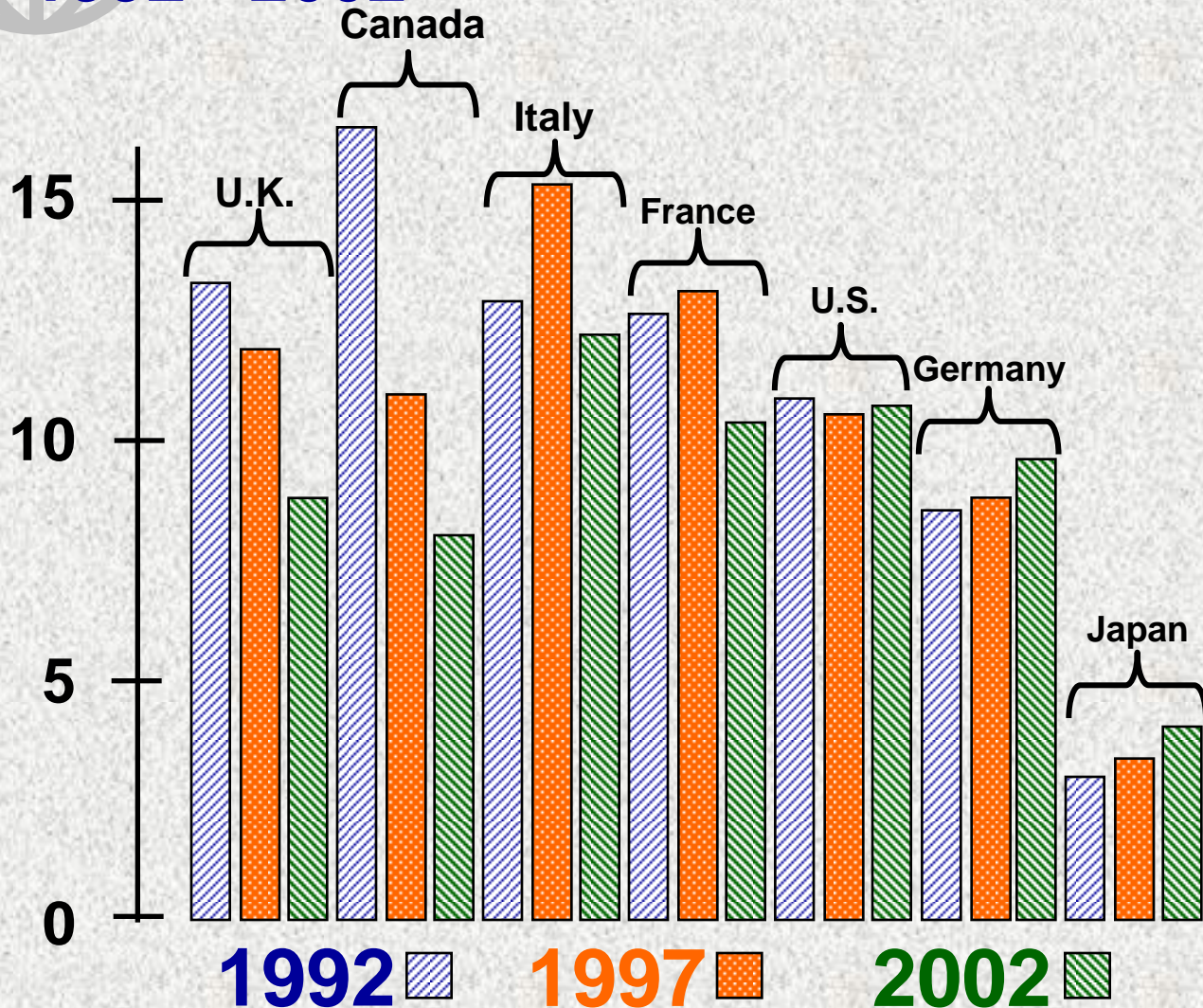




# GLOBAL PERSPECTIVE

## The Misery Index, Selected Nations

### 1992 - 2002



Source: Bureau of Labor Statistics

# **THE LONG-RUN PHILLIPS CURVE**

**Aggregate-Supply Shocks**

**Stagflation's Demise**

**Short-Run Phillips Curve**

**Long-Run Vertical Phillips s  
Curve**

**Disinflation**

# **TAXATION AND AGGREGATE SUPPLY**

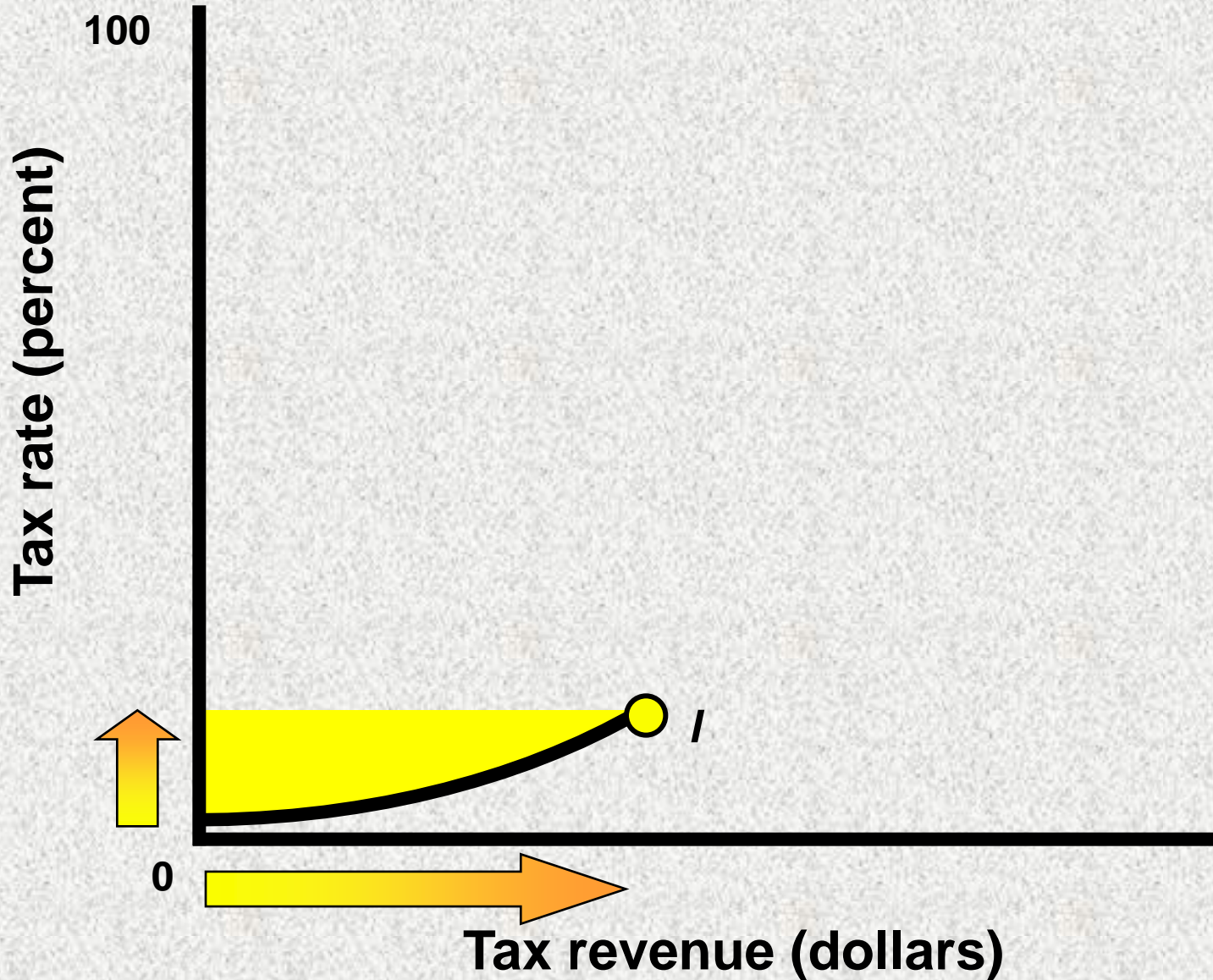
**Supply-Side Economics**

**Taxes and Incentives to  
Work**

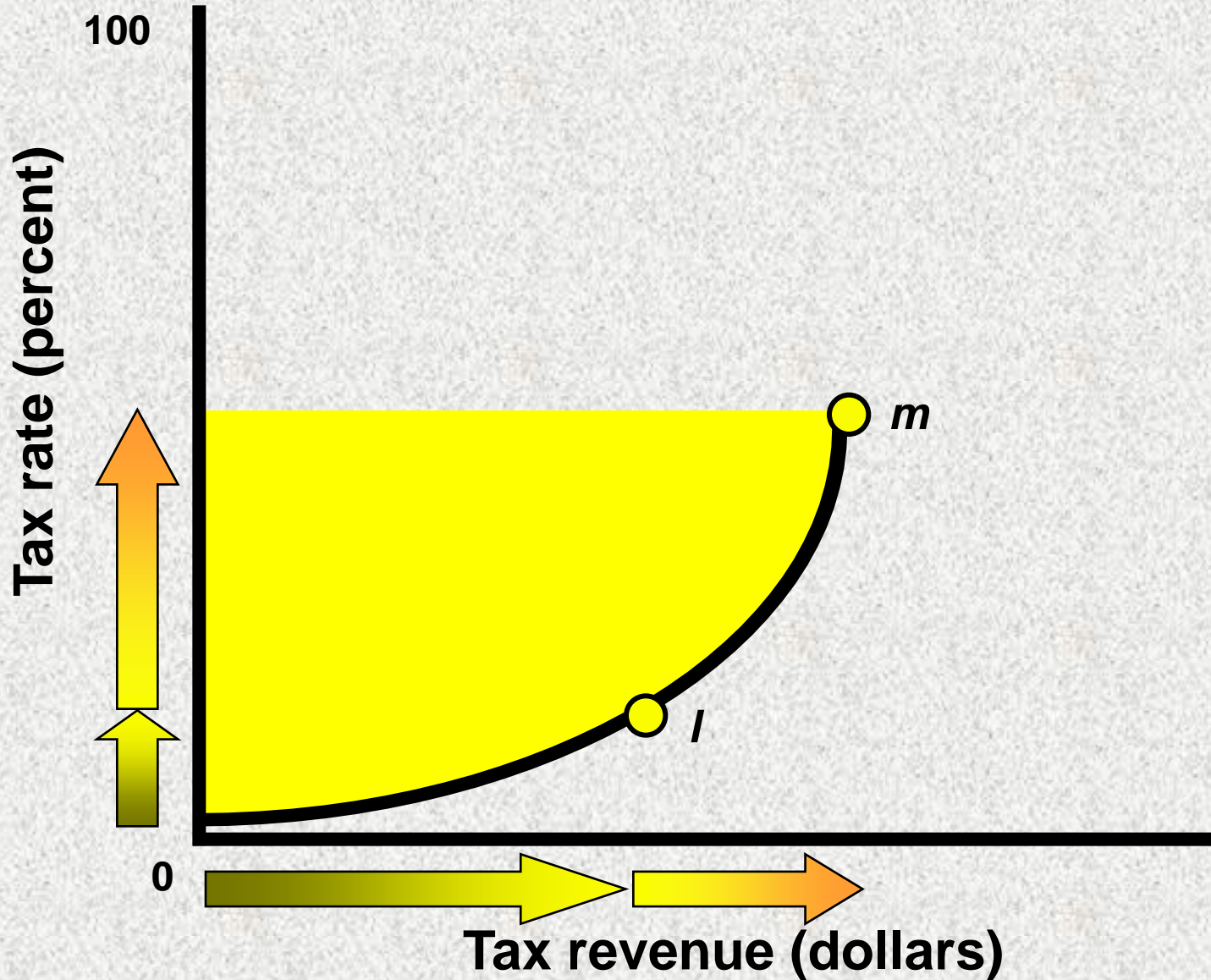
**Incentives to Save and  
Invest**

**Laffer Curve**

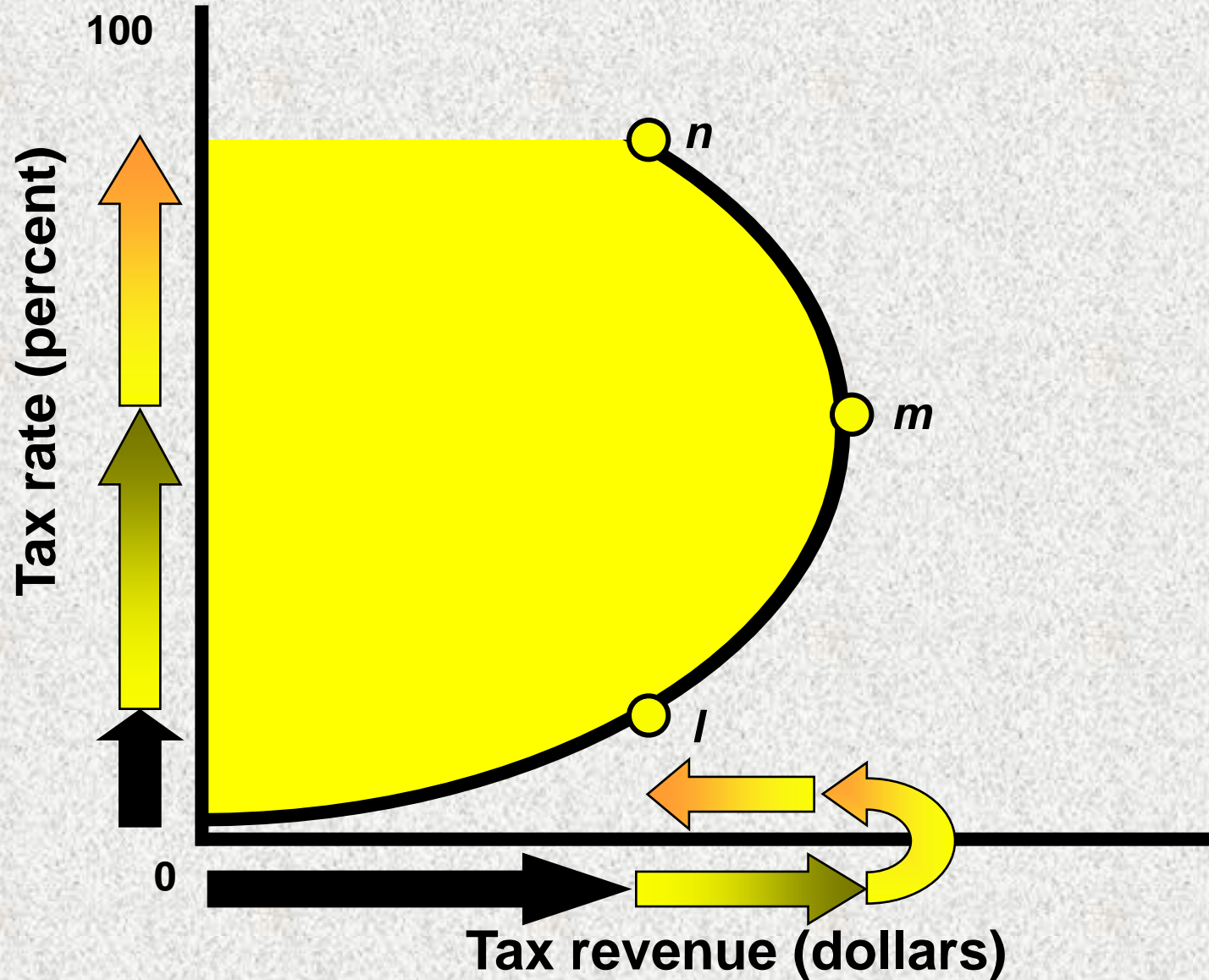
# THE LAFFER CURVE



# THE LAFFER CURVE

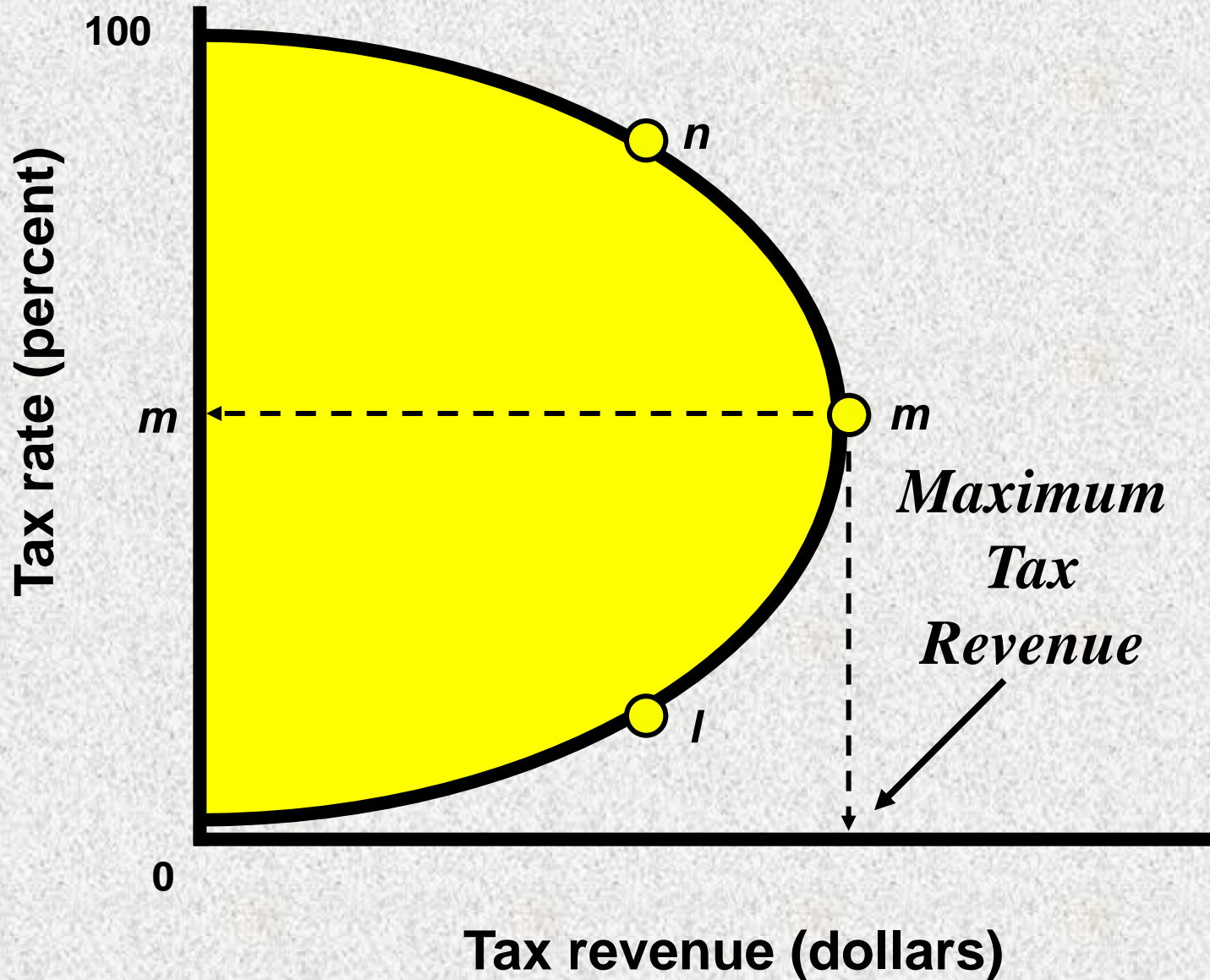


# THE LAFFER CURVE





# THE LAFFER CURVE



# **Criticisms of the Laffer Curve**

**Taxes, Incentives, and  
Time**

**Inflation or Higher  
Interest Rates**

**Position on the Curve**

**Rebuttal and Evaluation**

*Up next...*

***Economic Growth***

***Chapter 17***