Outline.

Applications of AD-AS model.

1. Stagflation. Oil Shock → (a) No H response
   (b) H response
2. Globalization.
3. High labor productivity.
4. Britain after WWI.
   (a) Return to gold standard.
      (Churchill, Keynes).
   (b) Improvements in unemployment insurance, better protection of workers' rights.
5. People expect higher prices, P_t.
   (a) No response by H authority.
   (b) Response by H authority.
1970s.
Big rise in inflation.
Rise in unemployment.
Fall in output.

Oil prices rose a lot.

Oil price hike in model

\[ P = (1 + \mu) W \]

\( \mu \) supply side shock
1. Know that $u$ must be higher for workers to settle for lower wage.

2. Will the economy actually go to the higher $u$?

Answer: disequilibrium dynamics of AD-AS model.
Summary:

How do we get to $Y_n'$, lower in unemployment?

Stayflation

Big surprise people used to AD shocks, which drive $P, Y$ in same direction.

Medium

Shock

Medium run.

Medium.
Discussion assumed no response

By authority

\[ \text{M} \]

\[ p \]

\[ p_e \]

\[ Y_n \]

\[ Y_0 \]

M authority was able to slow down the fall in \( Y \). But they can't change the ultimate outcome.

1970's M authority said: “We've got to stop this recession” increased M a lot. \( P \) ↑ a lot. Maybe short run support for \( Y \), but in the end \( Y \downarrow \).
Globalization.
Everyone competing with everyone else.

Impact on firms: more competition. Less opportunity to steal from consumers.

Workers: hurts bargaining.
\( Y \uparrow \) (strong) \( 2 \)

\( P \downarrow \) (weak)
\[ \frac{Y}{N} \]

\[ Y = aN \quad a \sim \text{Labor Productivity} \]

Since 2000, a strong connection?

\[ u = \frac{U}{L} = \frac{L-N}{L} = 1 - \frac{N}{L} \]

\[ = 1 - \frac{Y}{aL} \]

\[ \frac{1}{1+u} \]

\[ F(u, z) \]

\[ u_n \]

\[ u_n = 1 - \frac{Y}{aL} \]

\[ Y_n \uparrow \text{if } a \uparrow \]

\[ u_n \text{ no change if } a \uparrow \]

\[ \rho \]

\[ \text{AS}(\rho_e) \]

\[ \text{AS}'(\rho_e) \]
Short
Medium run a high

Medium run