

Outline.

Applications of AD-AS model.

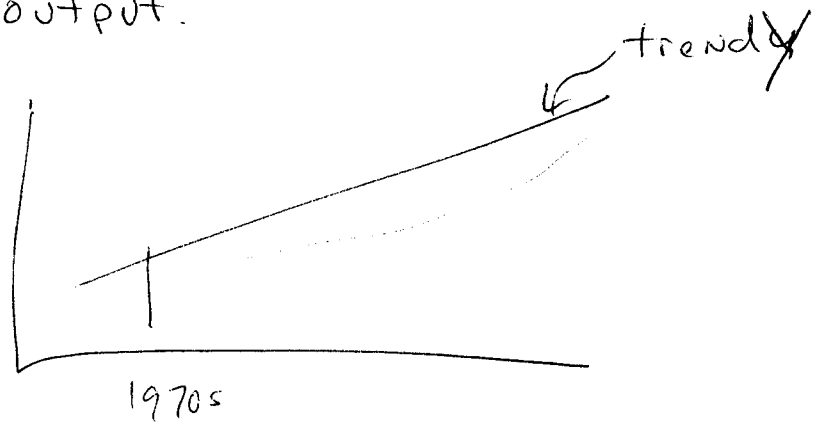
1. Stagflation. Oil Shock $\rightarrow$ (a) No M response
(b) M response
2. Globalization.
3. High Labor productivity.
4. Britain After WWI.
(a) return to Gold Standard.
(Churchill Keynes).
(b) Improvements in unemployment insurance, better protection of workers' rights.
5. People expect higher prices, $P^e \uparrow$.
(a) no response by M authority.
(b) response by ~~M~~ authority.

1970s.

Big rise in inflation.

Rise in unemployment

Fall in output.



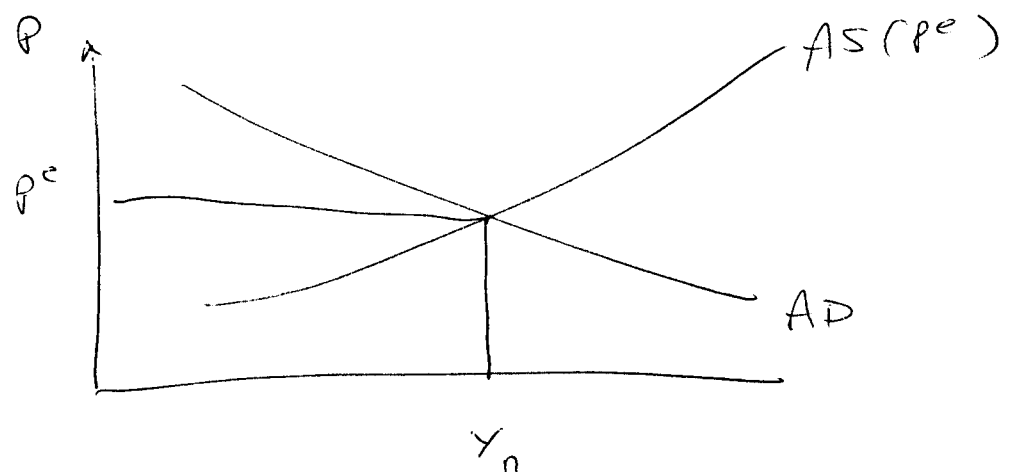
Oil prices rose a lot.

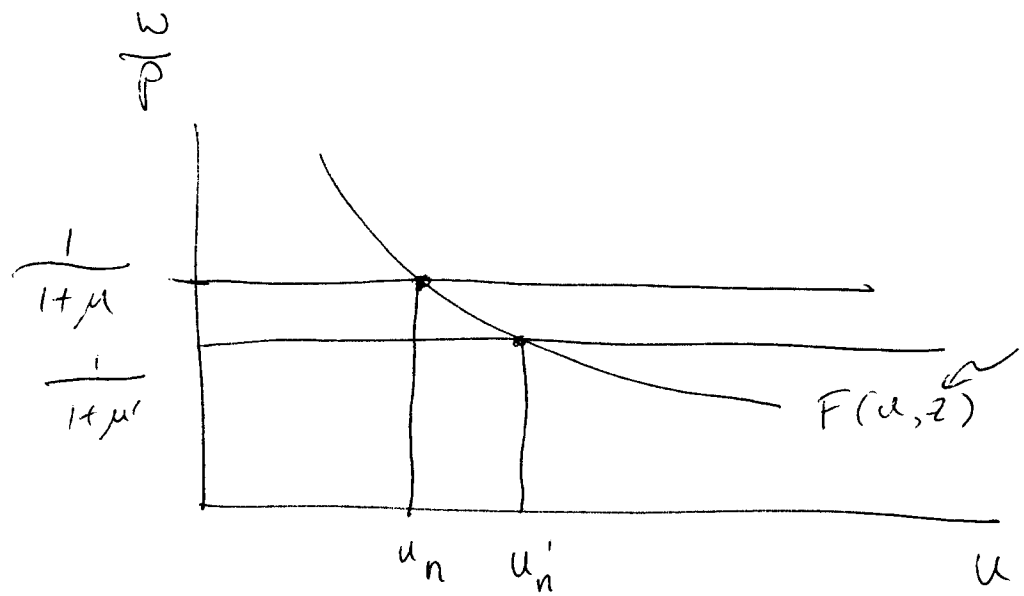
Oil price hike in model

$\mu \uparrow$

$$P = (1 + \mu)W$$

μ
supply
side
shock



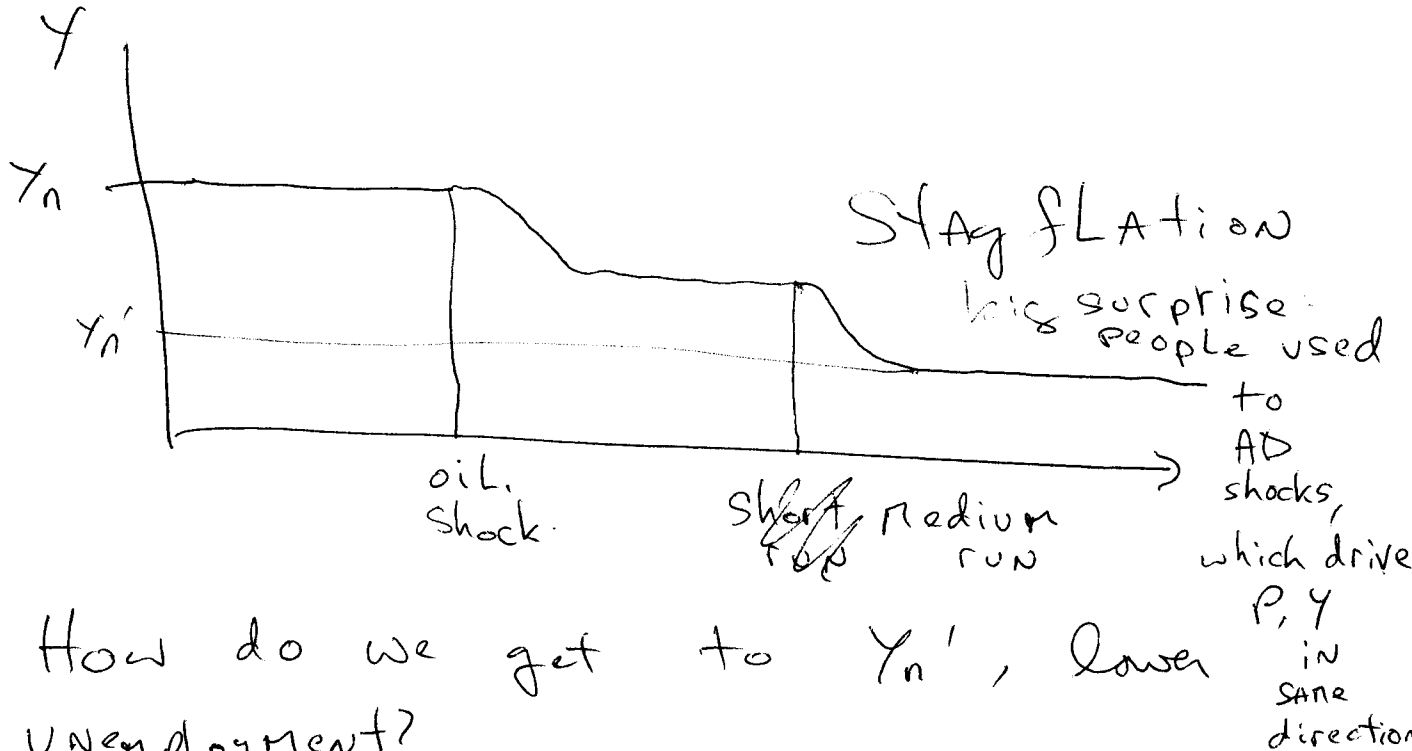


① Know that u must be higher for workers to settle for lower wage.

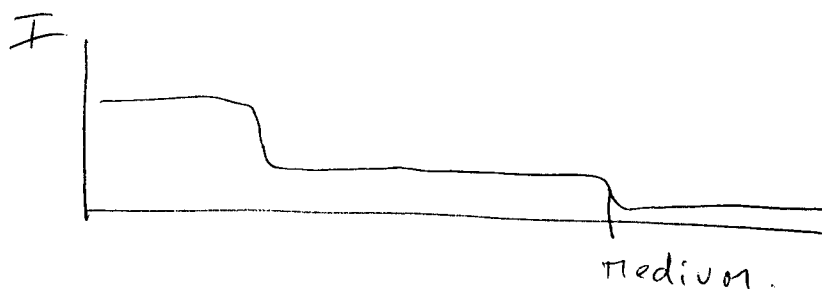
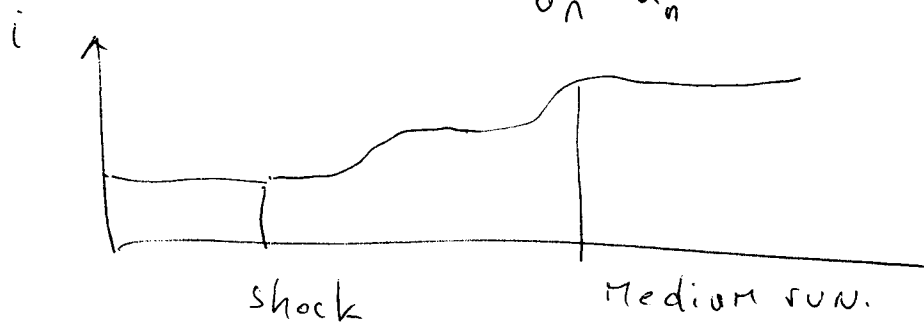
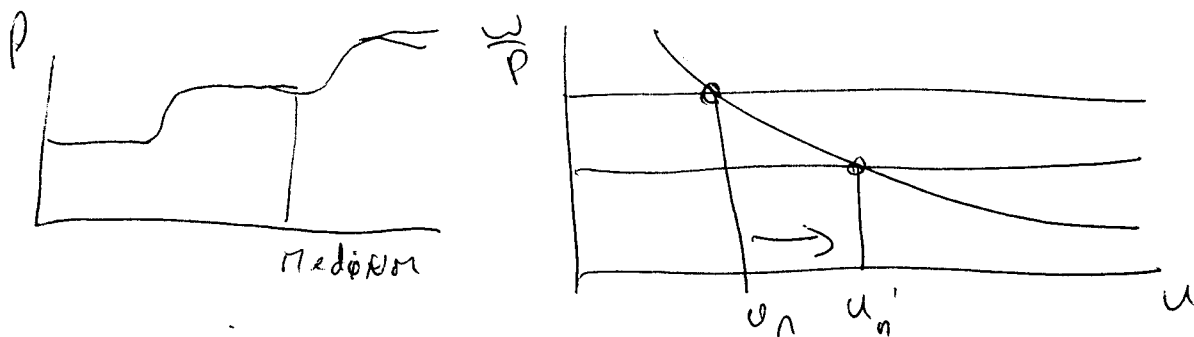
② Will the economy actually go to the higher u ?

Answer. disequilibrium dynamics of AD-AS model.

SUMMARY :

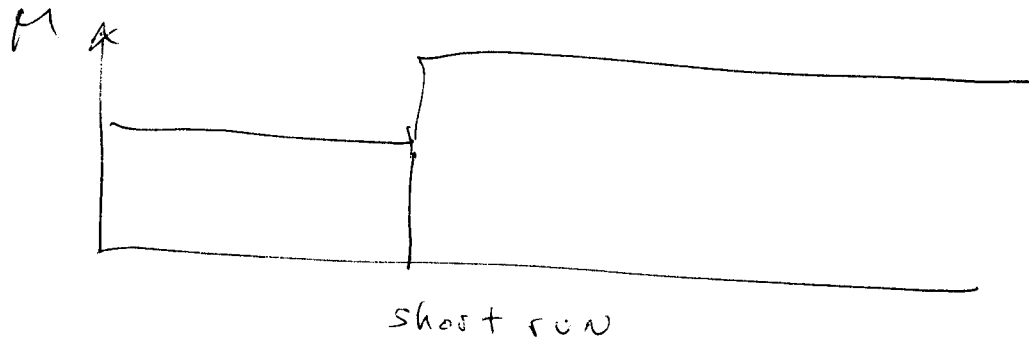
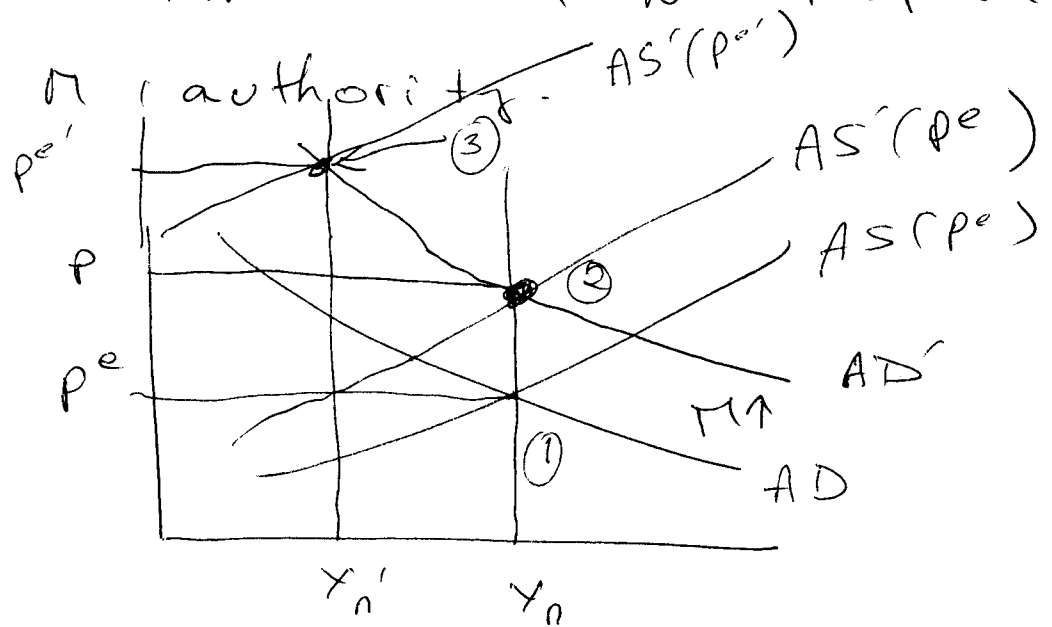


How do we get to Y_n' , lower unemployment?



Discussion ASSUMED NO response

by



Monetary authority WAS ABLE to slow down the fall in Y . BUT they CAN'T change the ultimate outcome.

1970's Monetary Authority said:

"we've got to stop this recession" Increased M A Lot. $P \uparrow$ a lot.

Maybe short run support for Y , but in the end $Y \downarrow$.

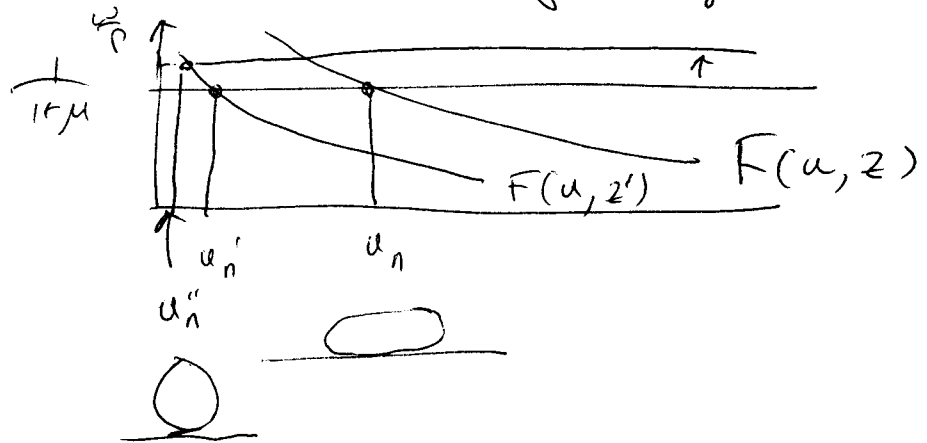
Globalization.

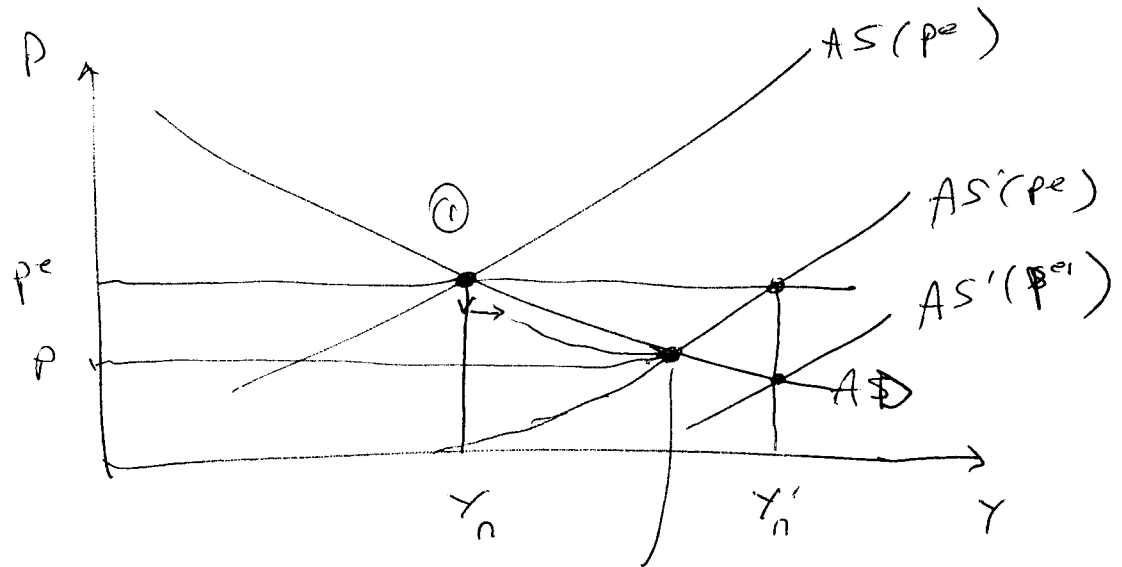
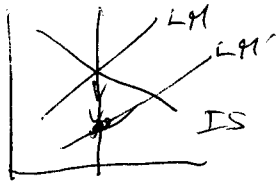
Everyone competing with everyone else.

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

$\mu \downarrow$

Workers: hurts bargaining





②

$Y \uparrow$ (strong)
 $P \downarrow$ (weak).

$$\frac{Y}{N}$$

$$Y = aN$$

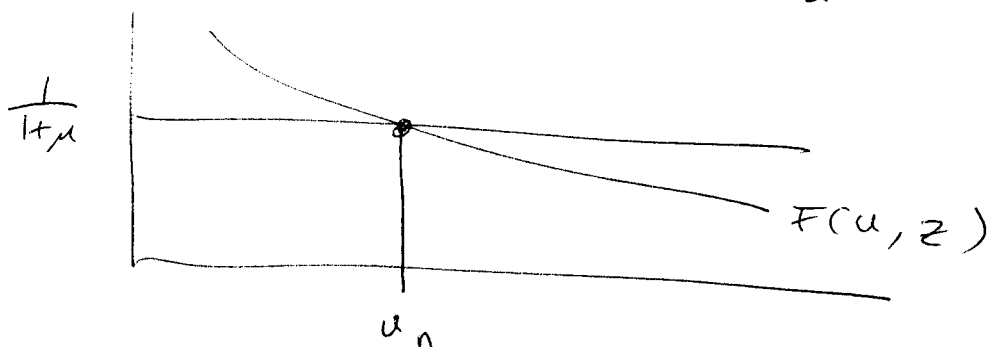
$a \sim$ Labor Productivity

$$a \uparrow$$

Since 2000 $a \uparrow$ employment not so strong. Connection?

$$u = \frac{U}{L} = \frac{L - N}{L} = 1 - \frac{N}{L}$$

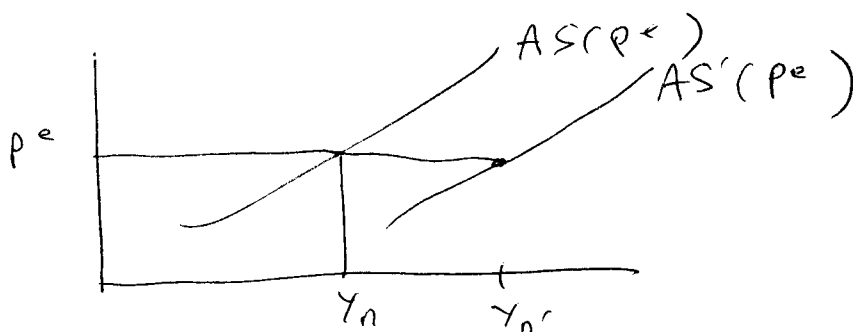
$$= 1 - \frac{Y}{aL}$$

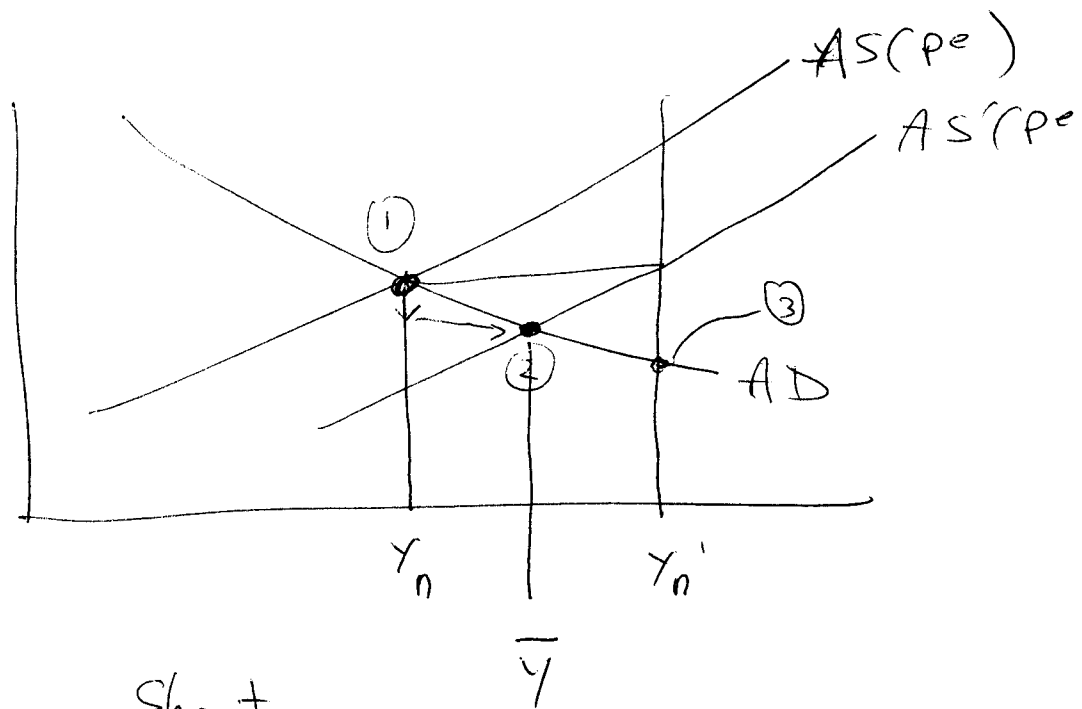


$$u_n = 1 - \frac{Y}{aL}$$

$Y_n \uparrow$ if $a \uparrow$

u_n no change if $a \uparrow$.





Short
~~Medium~~ run a high

