Equilibrium

1. Long-run equilibrium
   \[ \text{LAS} = \text{SAS} = \text{AD} \]
   Life is Good.

2. Short-run disequilibrium
   \[ \text{LAS} \neq \text{SAS} = \text{AD} \]
   Is LAS greater or less than AD=SAS?
Aggregate Demand/Aggregate Supply
Increase in Aggregate Demand
Decrease in Aggregate Demand
Increase in SR Aggregate Supply
Decrease in SR Aggregate Supply
Unemployment

Unemployment Rate = \frac{Unemployed}{Total \ Labor \ Force}

Unemployment Rate = \frac{5}{100} = 5\% \\

Labor Force Participation Rate = \frac{Working \ Adults}{Total \ Available \ Workers}

LFPR = \frac{95 \ Million}{100 \ Million} = 95\%
Types of Unemployment

1. Structural- Corresponds with structural changes in the economy.
   *Example:* Wagon wheel makers, blacksmiths
2. Cyclical- Corresponds with the business cycle.
3. Frictional – Corresponds with workers changing jobs.
   A. Migration
   B. Occupation mobility
Cyclical Unemployment and the Business Cycle

Expansion
- High Growth
- Low Involuntary Unemployment
- Life is good

Contraction
- No Growth or decreasing GDP
- High Involuntary Unemployment
- Life Sucks

Trend

GDP

Time
The Recession Dilemma, getting back to LAS
Moving from point B to A through Government

1. Government Expenditures (+)
   \[\uparrow \text{Government} \rightarrow \uparrow \text{GDP}\]
   
   *Examples*: Military Spending, Infrastructure

2. Taxes (-)
   \[\uparrow \text{Taxes} \rightarrow \downarrow \text{GDP}\]
   
   A. Tax Rate, Reagan 1980.
The validity of the tax break depends on how the tax break is perceived.

1. If the tax break is perceived as permanent, households and businesses are more likely to spend what they have today.

2. If the tax break is perceived as temporary, households and businesses are more likely to put the money in the bank or pay off bills.

Evidence for the 2000 tax breaks suggests that households perceived the tax break to be temporary. It did not produced large results.
3. Transfer Payments

*Examples*: Social Security and Welfare

What should government do?

*Expansion:*
\[ \downarrow \text{Government expenditures}, \uparrow \text{Taxes}, \downarrow \text{Transfer payments} \]

*Contraction:*
\[ \uparrow \text{Government expenditures}, \downarrow \text{Taxes}, \uparrow \text{Transfer payments} \]
Government Should:
1. Decrease expenditures
2. Increase taxes
3. Decrease transfer payments

Trend

Government Should:
1. Increase expenditures
2. Decrease taxes
3. Increase transfer payments

Trend
But, the role of government is anything but clear . . .

1. Classical School
   - Founded by Adam Smith, Hayek, Friedman

Assumptions
Wages and prices are flexible.
Markets are efficient and unemployment is voluntary.
Therefore the role of government is limited to the provision of public goods.
2. Keynesian School

Assumptions

Wages and prices are rigid. Markets are inefficient and unemployment is involuntary.

Therefore, government has an active role in the economy.

This begs the question:

*What is the proper role of Government?*
Commanding Heights

Web Addresses:
http://www.pbs.org/wgbh/commandingheights/lo/

http://www.pbs.org/wgbh/commandingheights/lo/ideas/vid_essaylist.html