Back to Business Cycles

Our Starting Point

\[ Y = Y_p \]
\[ U = U_n \]

A Change in Demand

\[ Y < Y_p \]
\[ U > U_n \]

A Reduction in Productivity
A Reduction in Productivity

\[ Y < Y_p \]
\[ U > U_n \]

Well, \( Y < Y_p \) as we measure \( Y_p \)

A Boom

\[ Y > Y_p \]
\[ U < U_n \]

What Can We Do?

Build a Monument!

A temporary increase in government spending will shift demand from \( D' \) to \( D'' \)
A temporary tax cut will shift $D'$ to $D''$.

But only if there is no bequest motive.

The Federal Reserve can use its power to cut interest rates, albeit temporarily.

Lower interest rates increase demand.

The Federal Reserve can use its power to cut interest rates, albeit temporarily.
Lincoln’s Law means people adjust to the change.

In fact if it is a temporary change, the effects have their affects in reverse when \( Y > Y_p \).

Don’t forget: these effects have their affects in reverse when \( Y > Y_p \).

I could go through and show the same effects for spending, tax cuts, monetary policy and expectation changes in reverse.

But I won’t. That would be boring.
Are we done yet?

No! The course is not over.

Applications of Fiscal and Monetary Policy are more complicated

And this discussion of what causes business cycles is much too simple!

End

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