Week #5

Help

Week Five: Unemployment, Inflation, and Stagflation

Unemployment and inflation are two of the most important problems in macroeconomics, and in most cases, macroeconomists can solve at least one of them but only by worsening the other. For example, expansionary fiscal or monetary policy can usually pull an economy out of a recession. But such actions may cause inflation. On the other hand, contractionary policies typically can be used to fight inflation. But often at the cost of more unemployment and recession.

But what happens when an economy faces both high unemployment and soaring inflation-as many nations of the globe did during the turbulent 1970s? Are traditional, Keynesian-style monetary and fiscal policies still effective in fighting such "stagflation?"

In the lectures this week, we are going to explore this question while we look more closely at the problems of inflation and unemployment. In doing so, we're going to learn about one of the great debates in macroeconomic theory: Is there a clear tradeoff between unemployment and inflation as advocates of the so-called "Phillip's Curve" suggest?

During this week, we're also going to compare and contrast the Keynesian and Monetarist views of stagflation and then illustrate why the doctrine of Supply-side economics emerged in the 1980s as a viable political alternative to these two competing economic camps.

Key Questions for Week Five: Unemployment, Inflation, and Stagflation

1. Why is the distinction between cyclical, frictional, and structural unemployment important?

2. Define the unemployment rate.

3. Explain Okun's law.

4. Illustrate demand-pull inflation.

5. Illustrate cost-push inflation.

6. What is the Keynesian dilemma that arises with stagflation?

7. What is the core or inertial rate of inflation?

8. Why are inflationary expectations important?

9. What are adaptive expectations?

10. Illustrate how adaptive expectations lead to an inertial inflation rate.

11. What relationship does the Phillips Curve purport to illustrate?

12. What happened in the 1970s to shake economists' faith in the Phillips Curve?

13. What is the standard explanation of the Phillips Curve breakdown?

14. According to the Monetarists, the disappearance of the Phillips Curve in the 1970s may best be explained through what two things?

15. What is the natural or lowest sustainable rate of unemployment?

16. What are the policy implications of the Monetarist's natural rate theory, particularly with regard to Keynesian activism?

17. Is the natural rate of unemployment constant?

18. Illustrate an inflationary spiral from the Monetarists' perspective. How do the Monetarists stop an inflationary spiral?

19. Contrast the traditional Keynesian versus Monetarist approaches to wringing inflation out of the economy. Why does neither have political appeal?

20. Illustrate how Supply-side economics offers a very painless way to avoid both the Keynesian stagflation dilemma and the bitter Monetarist cure for an inflationary spiral.

21. Illustrate the Laffer Curve.

Week #5 Quiz

Created Mon 1 Apr 2013 3:16 PM PDT

Last Modified Mon 6 Jan 2014 1:16 AM PST