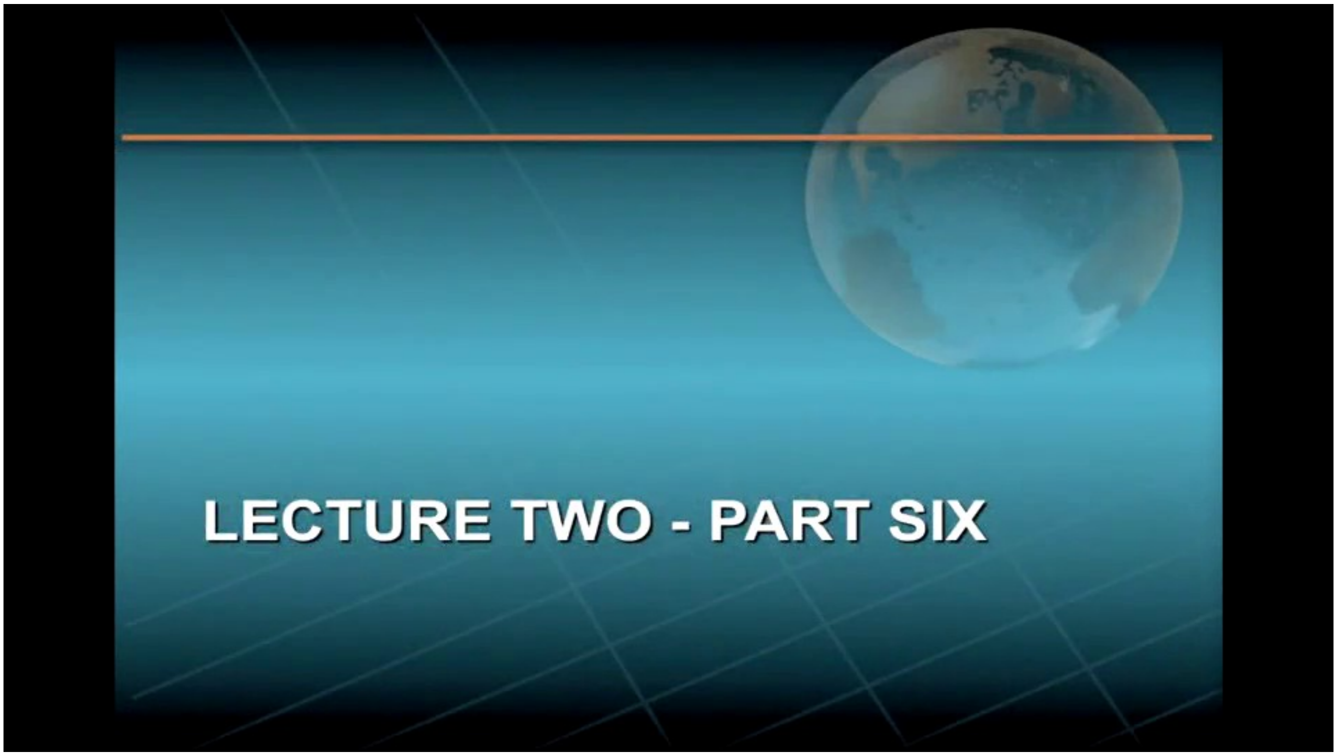
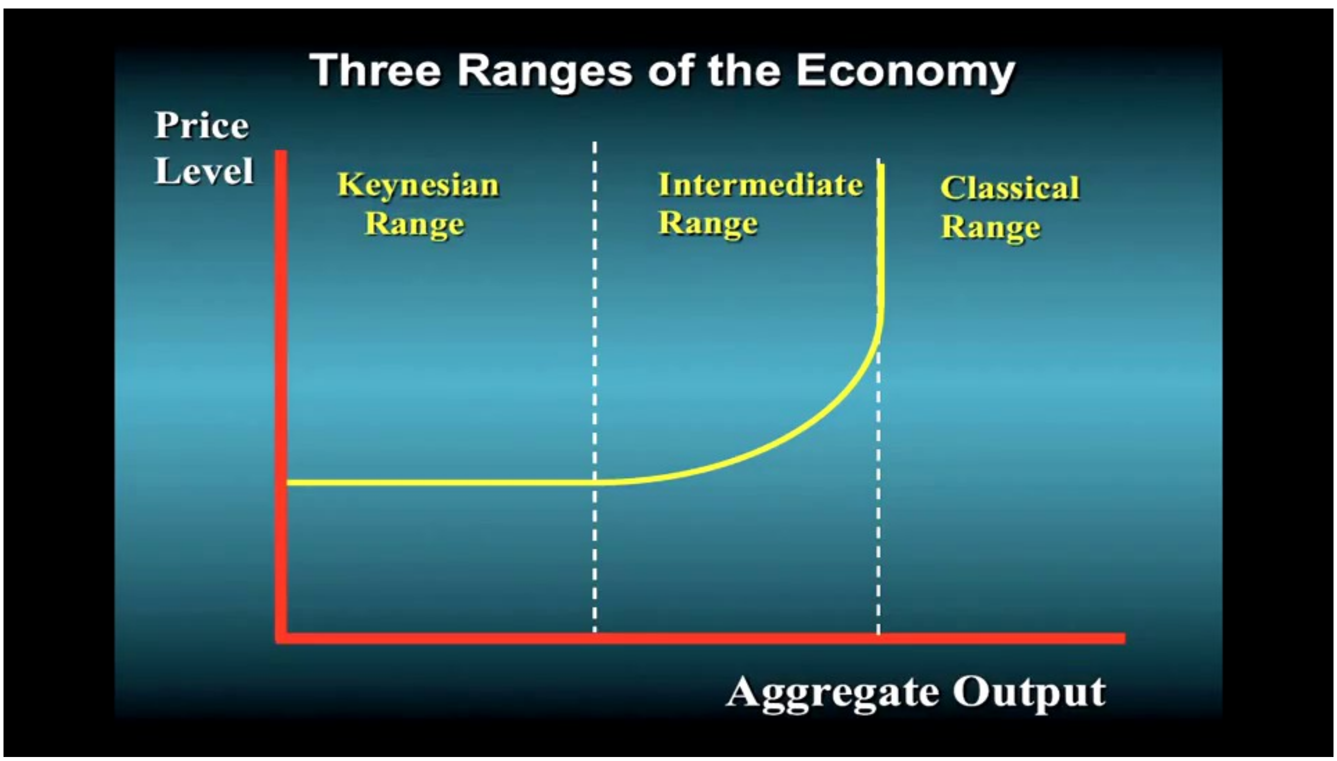
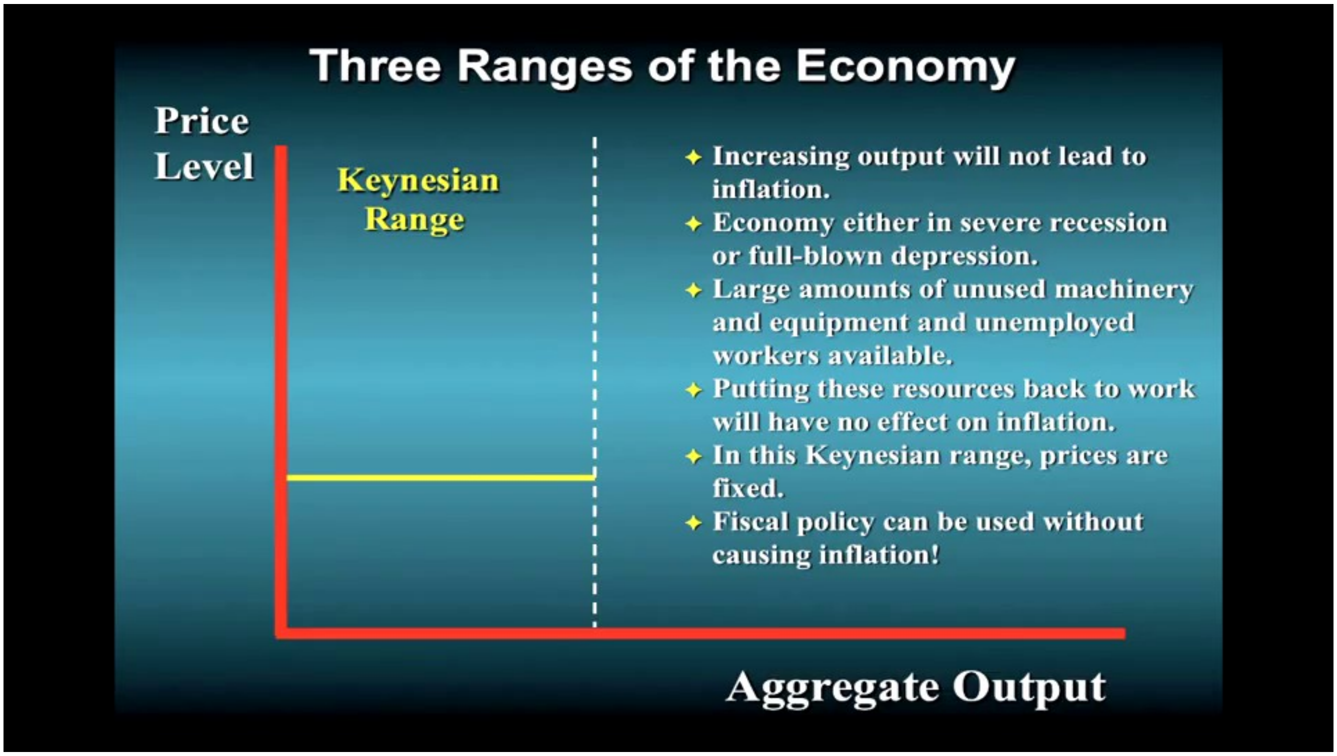
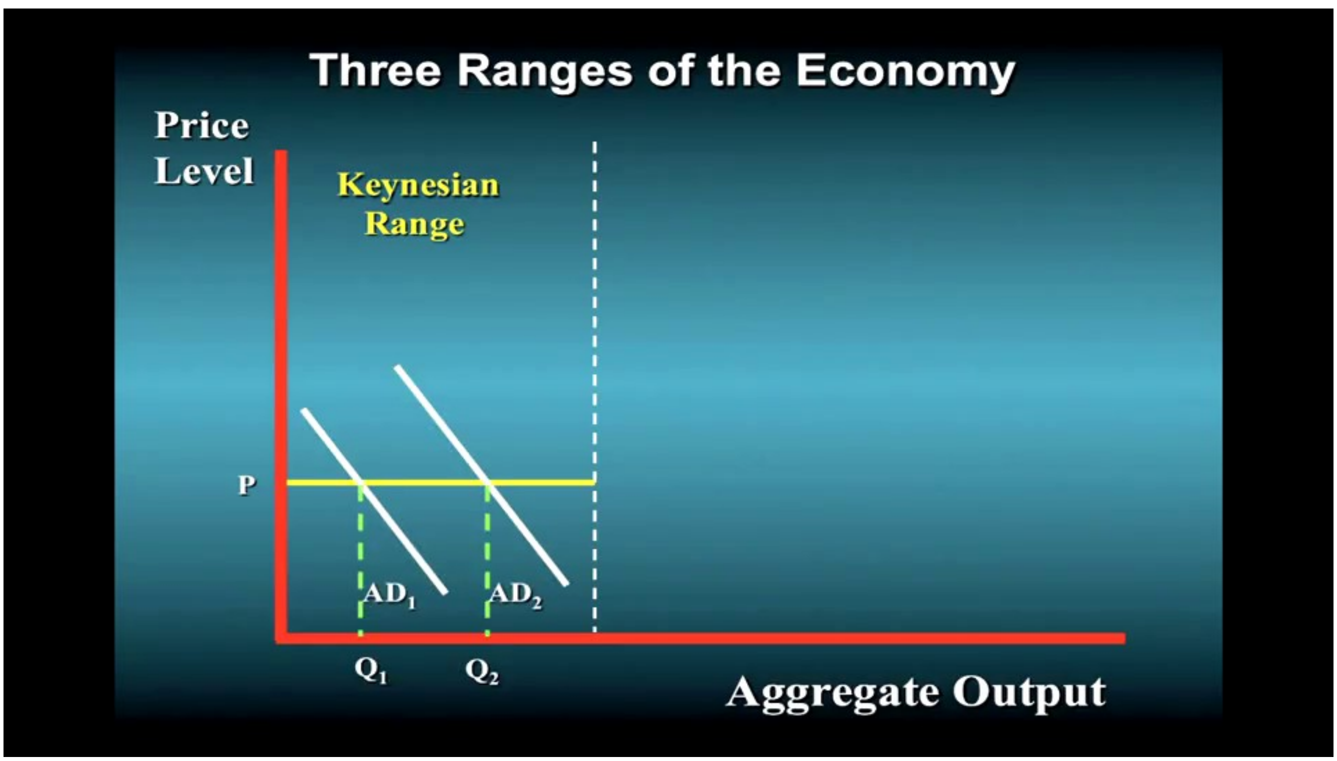
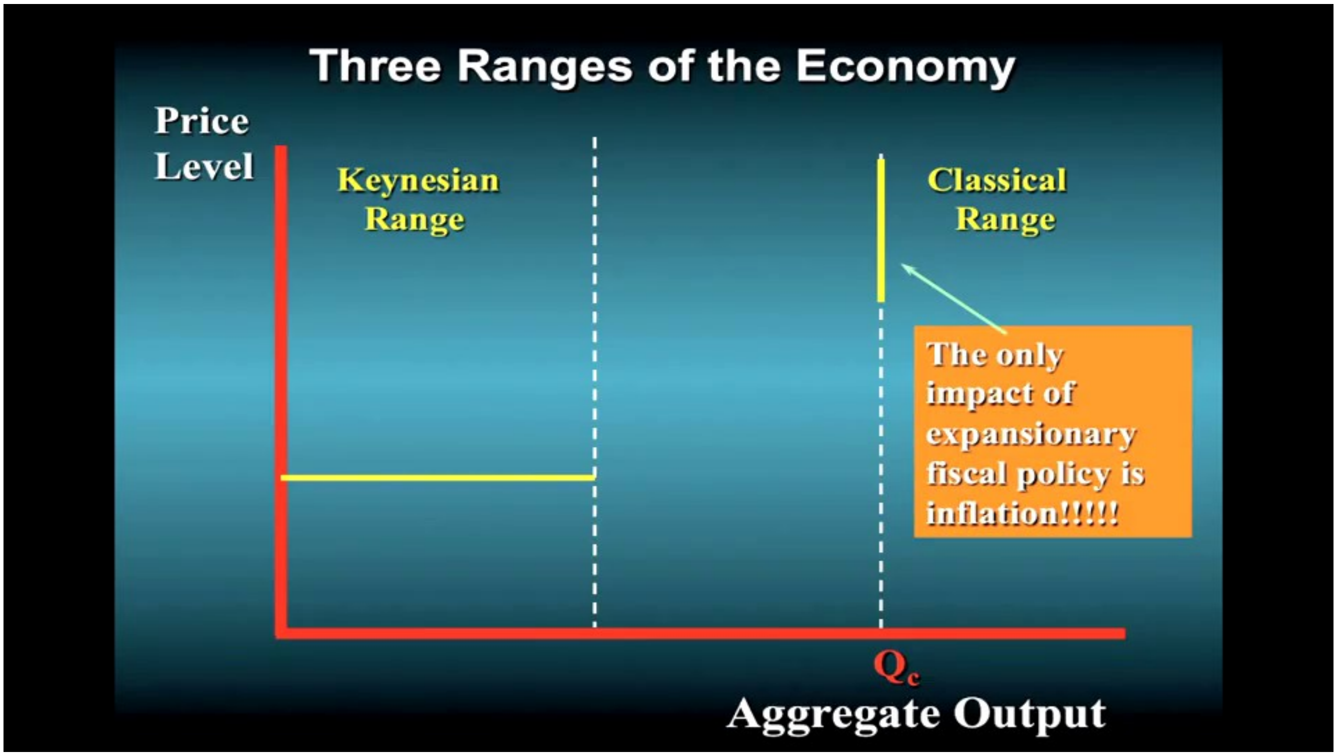
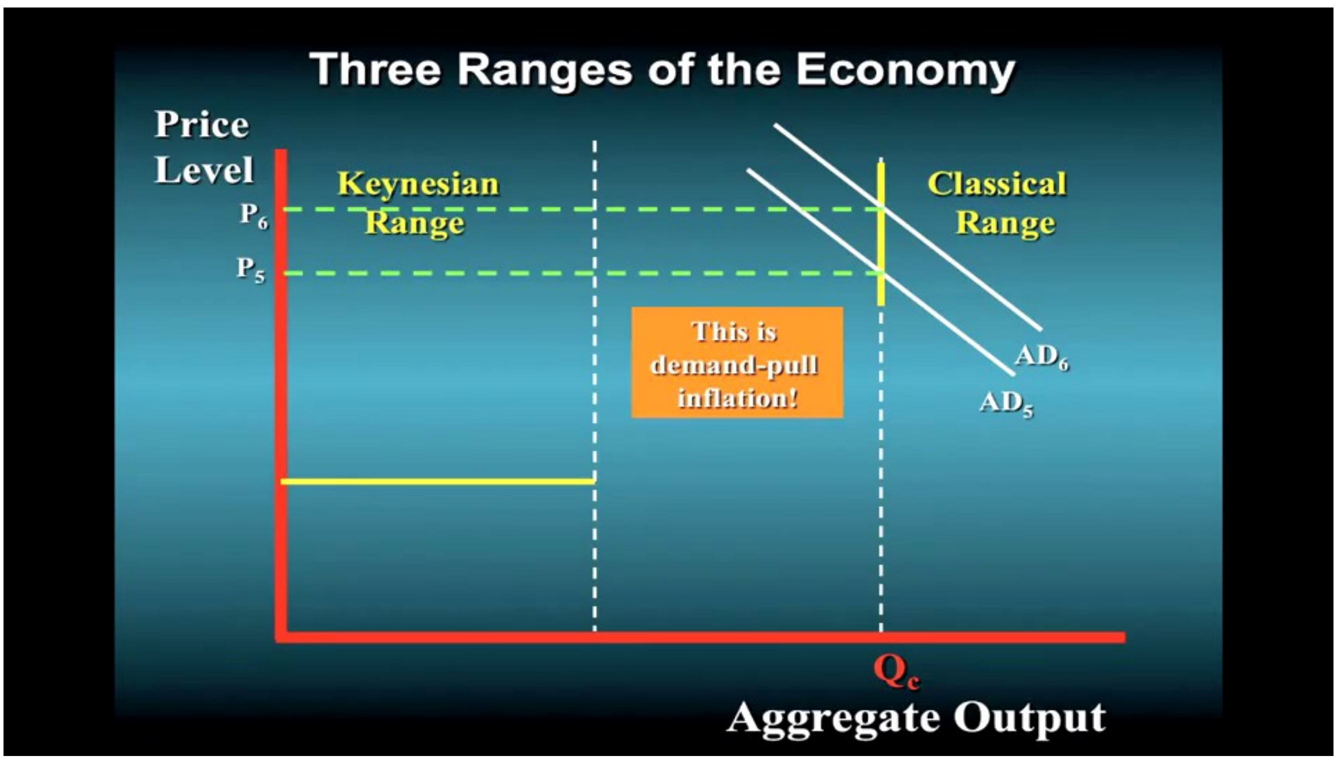

LECTURE TWO - PART SIX

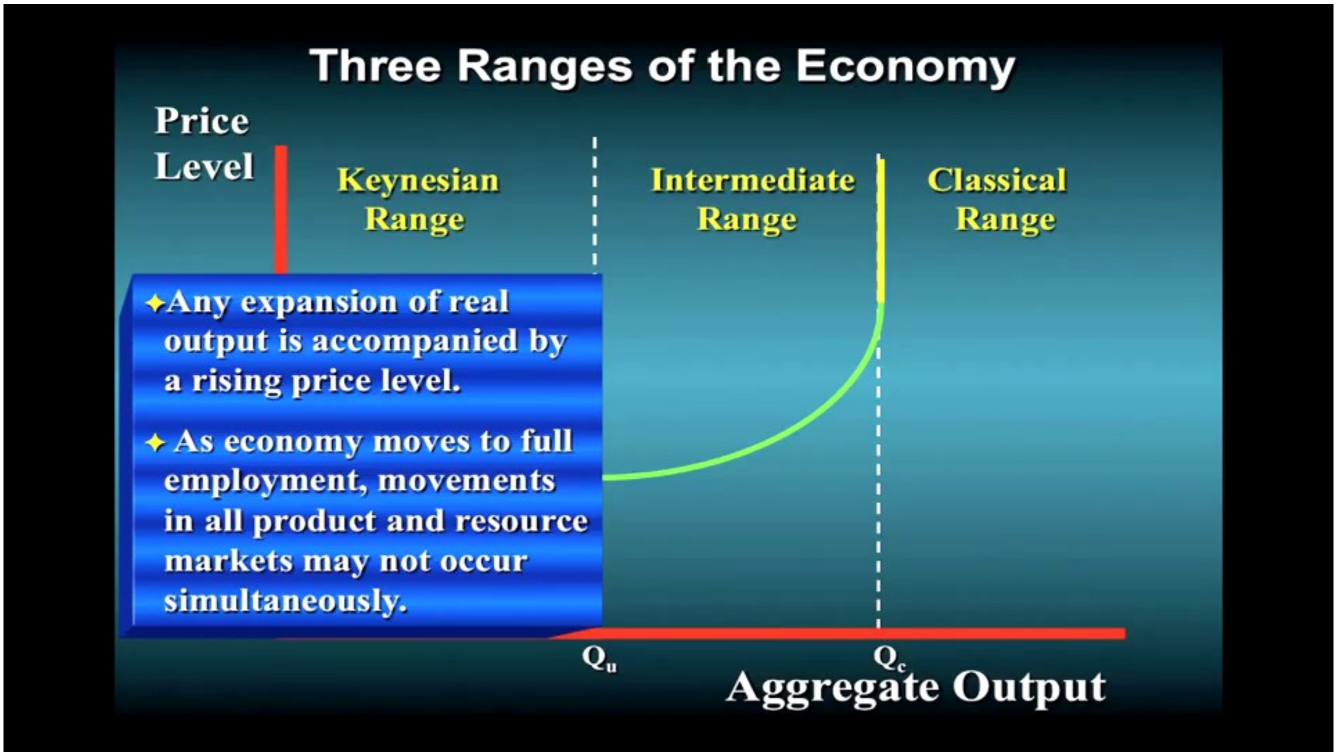

Three Ranges of the Economy
Price Level
Keynesian Range
Intermediate Range
Classical Range
Aggregate Output

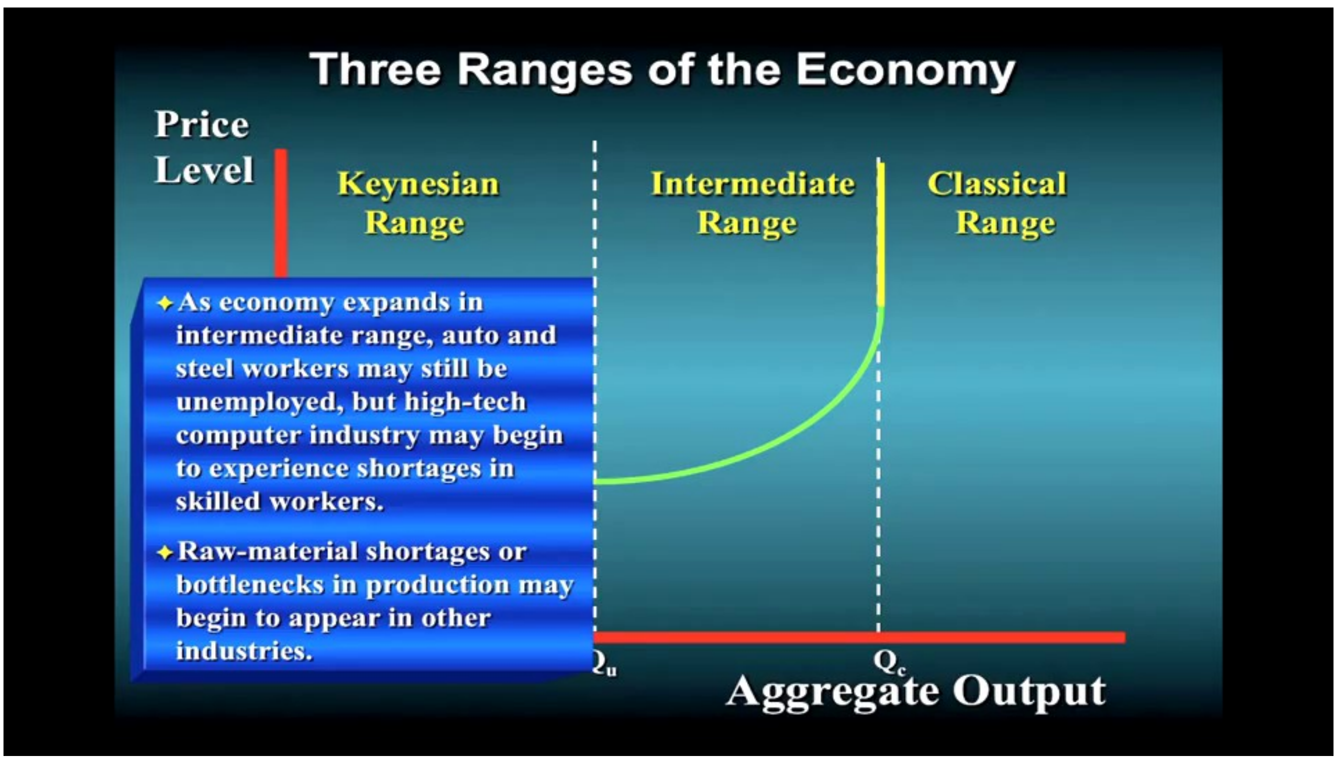

Three Ranges of the Economy
Price Level
Keynesian Range
✦ Increasing output will not lead to inflation.
✦ Economy either in severe recession or full-blown depression.
✦ Large amounts of unused machinery and equipment and unemployed workers available.
✦ Putting these resources back to work will have no effect on inflation.
✦ In this Keynesian range, prices are fixed.
✦ Fiscal policy can be used without causing inflation!
Aggregate Output

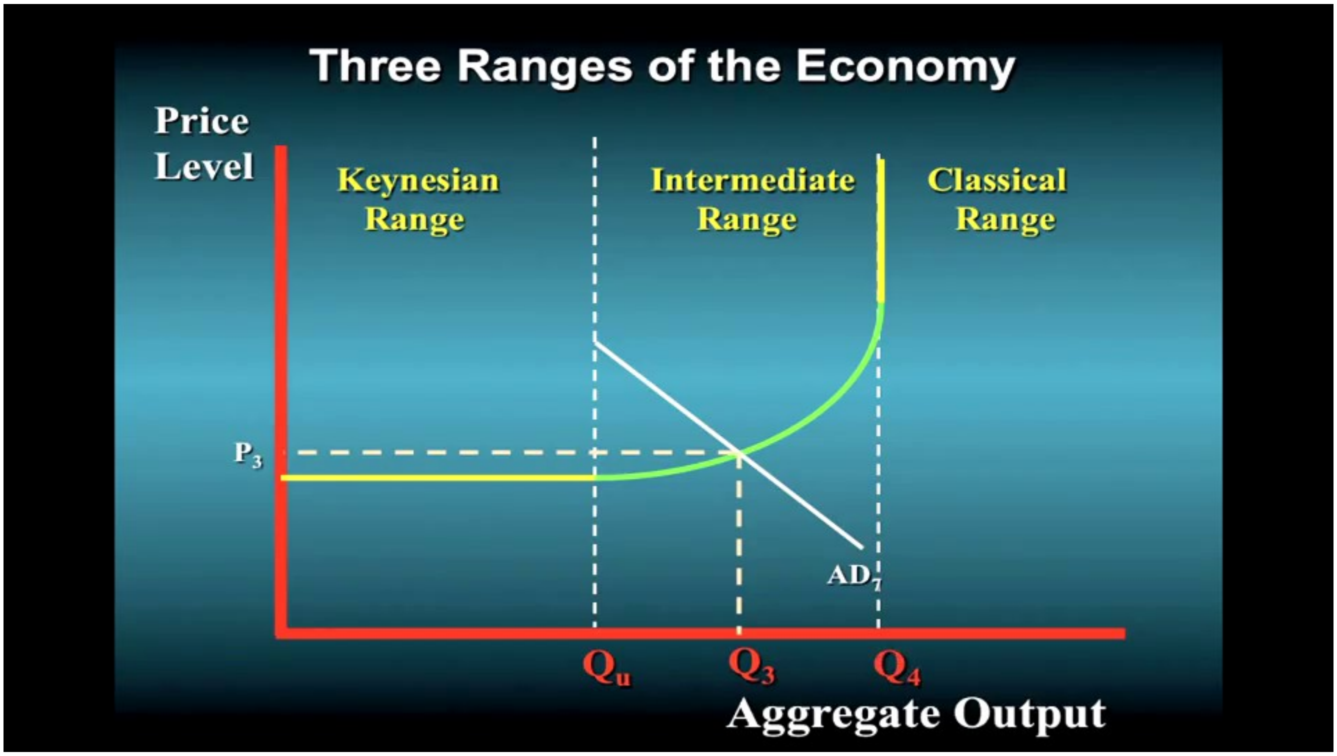

Three Ranges of the Economy
Price Level
Keynesian Range
P
AD_1
AD_2
Q_1
Q_2
Aggregate Output

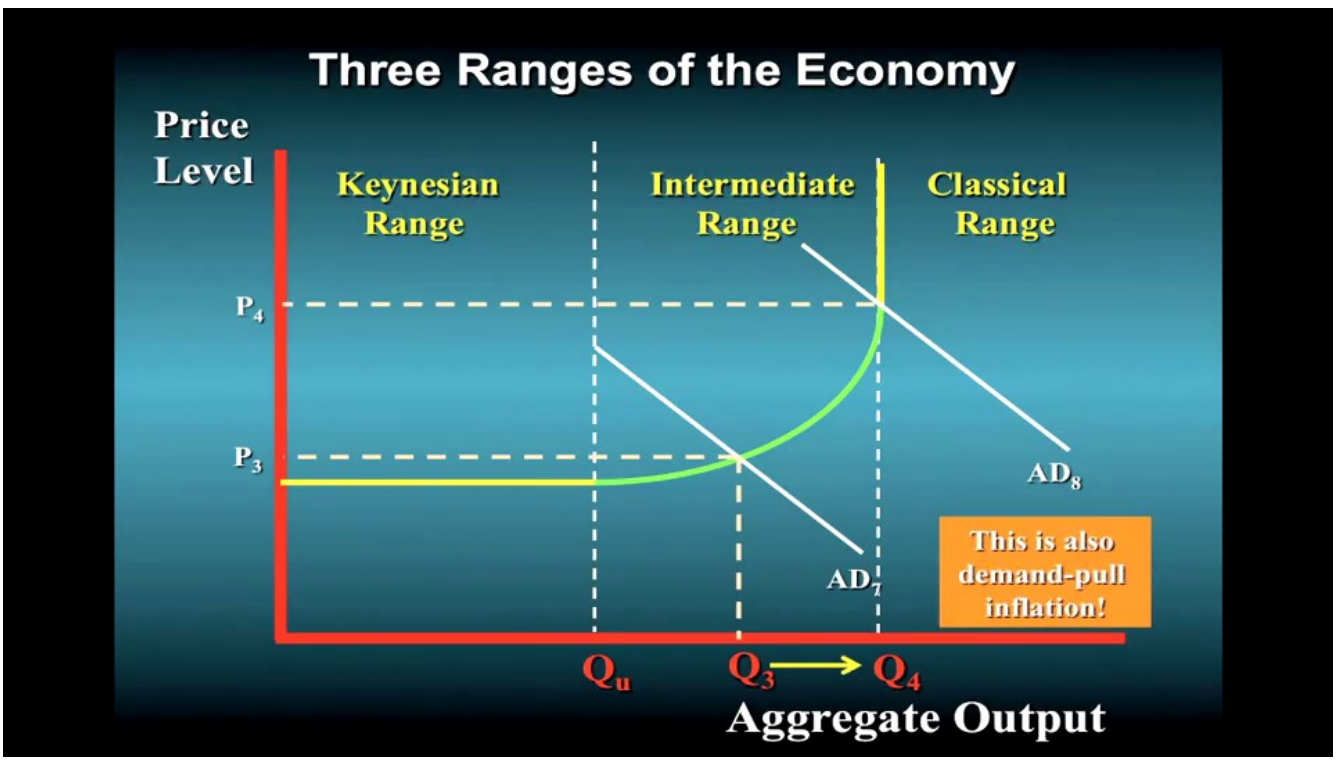

Three Ranges of the Economy
Price Level
Keynesian Range
Classical Range
The only impact of expansionary fiscal policy is inflation!!!!!
Q_c
Aggregate Output

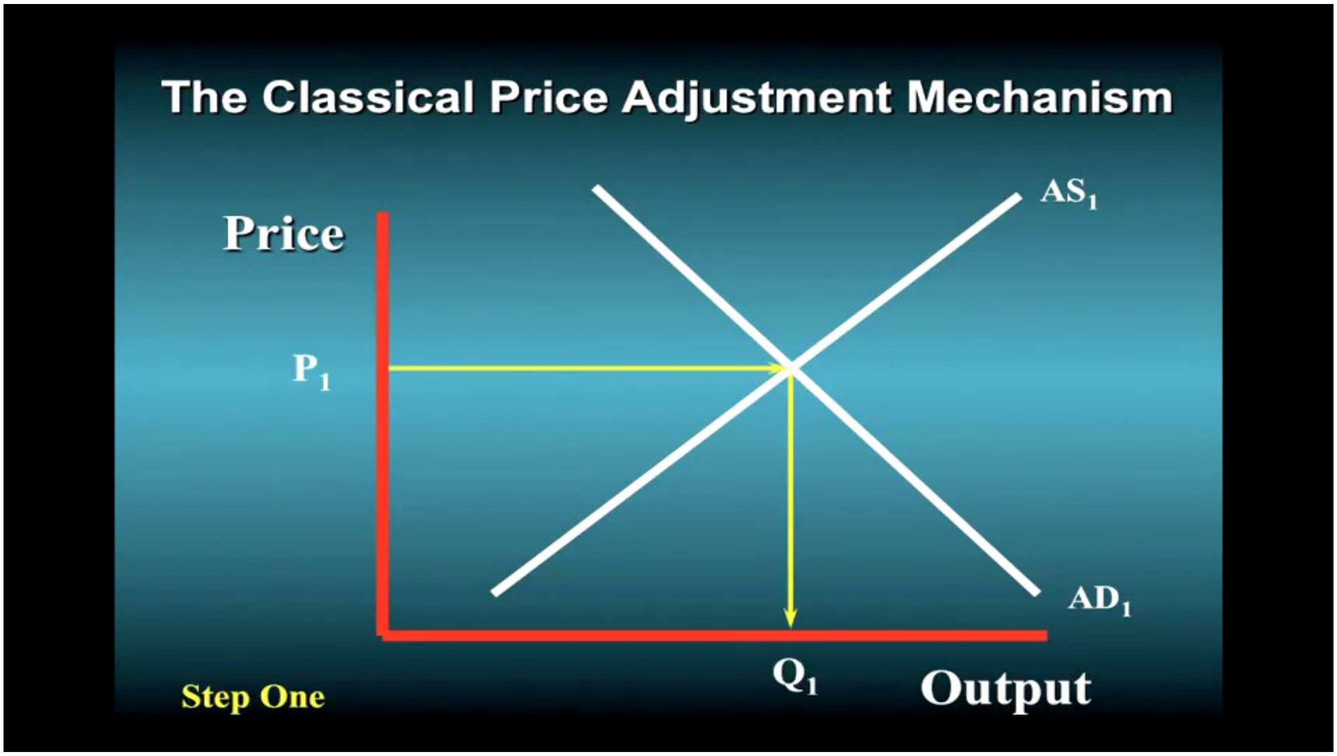

Three Ranges of the Economy
Price Level
P6
P5
Keynesian Range
Classical Range
This is demand-pull inflation!
AD6
AD5
Q_c
Aggregate Output

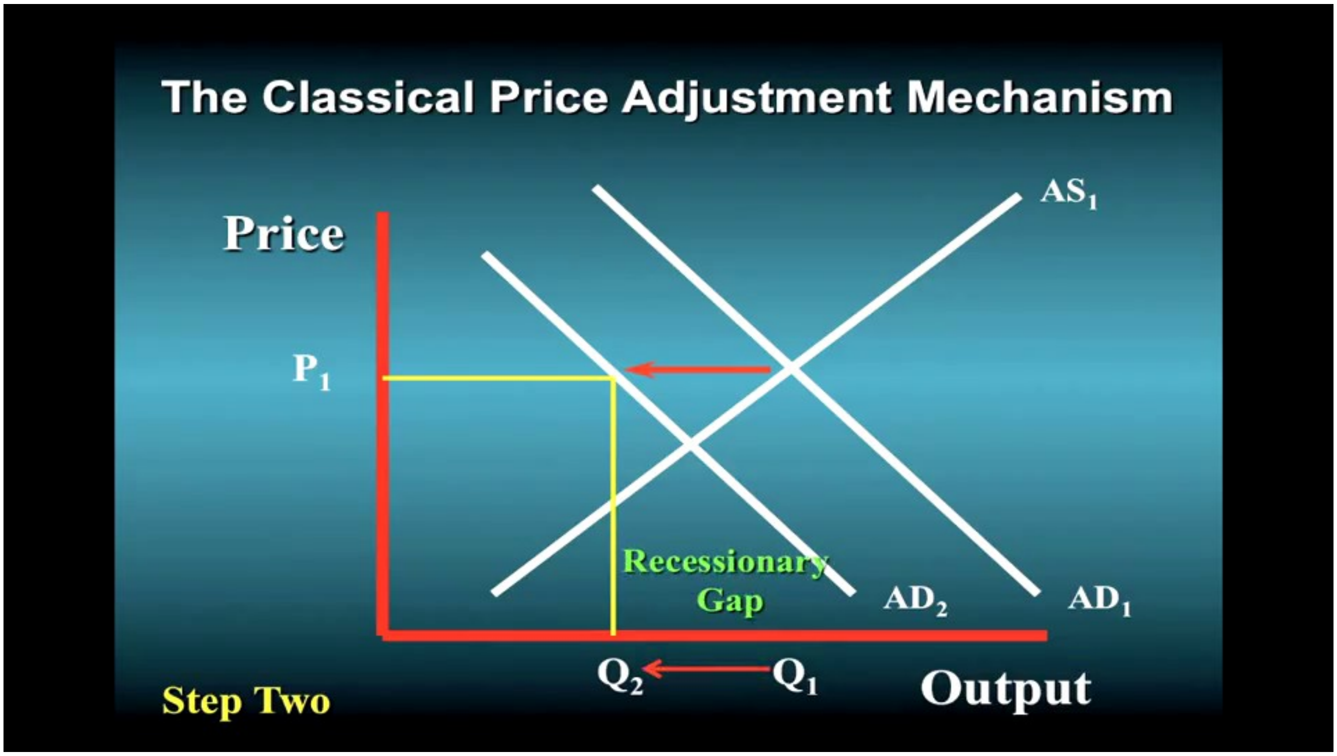

Three Ranges of the Economy
Price Level
Keynesian Range
Intermediate Range
Classical Range
✦Any expansion of real output is accompanied by a rising price level.
✦As economy moves to full employment, movements in all product and resource markets may not occur simultaneously.
Q_u
Q_c
Aggregate Output

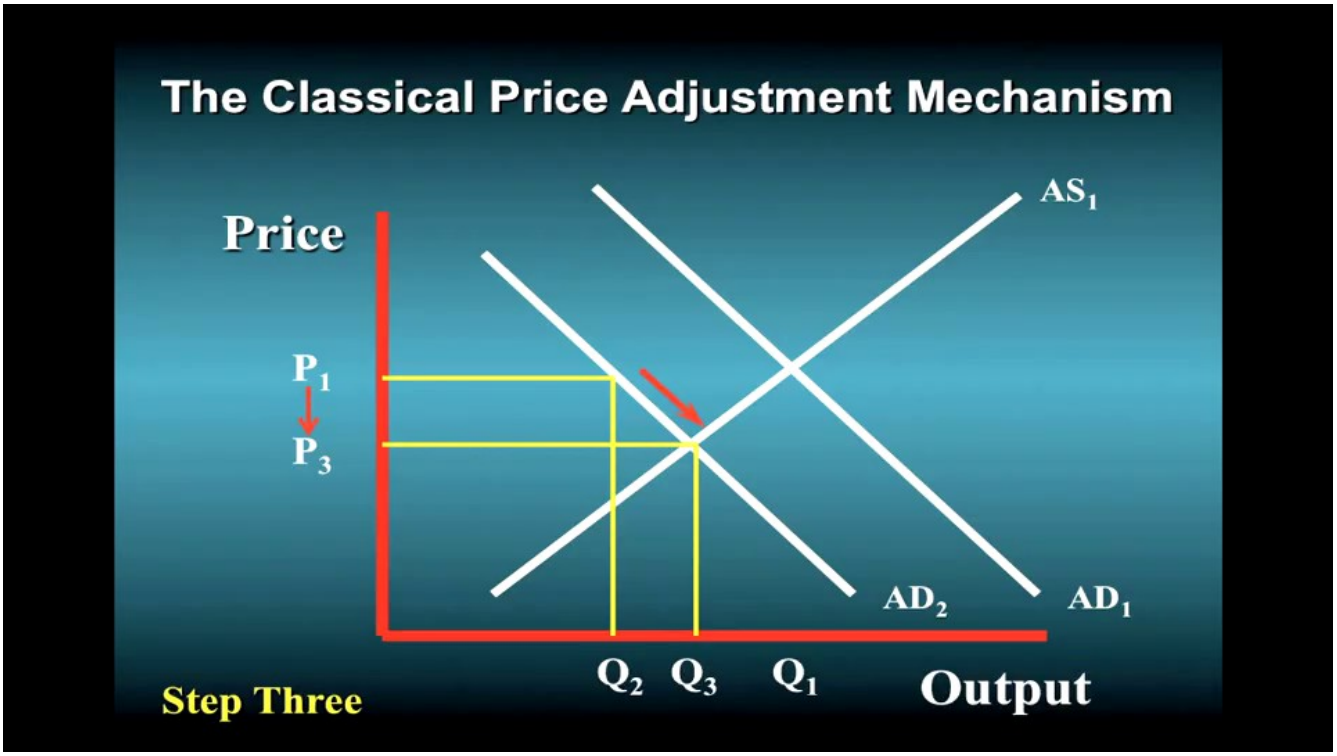

Three Ranges of the Economy
Price Level
Keynesian Range
Intermediate Range
Classical Range
✦As economy expands in intermediate range, auto and steel workers may still be unemployed, but high-tech computer industry may begin to experience shortages in skilled workers.
✦Raw-material shortages or bottlenecks in production may begin to appear in other industries.
Q_c
Aggregate Output

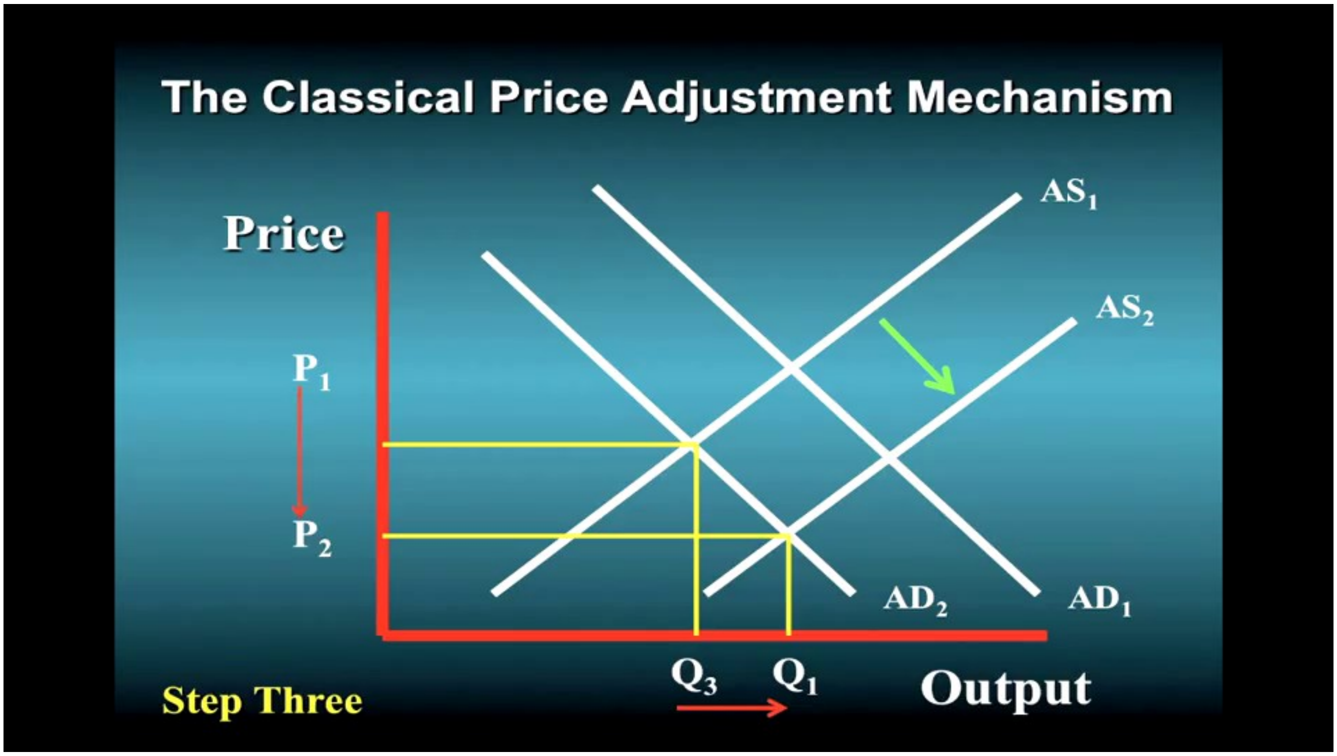

Three Ranges of the Economy
Price Level
Keynesian Range
Intermediate Range
Classical Range
P3
AD7
Qu
Q3
Q4
Aggregate Output


Three Ranges of the Economy
Price Level
Keynesian Range
Intermediate Range
Classical Range
P4
P3
AD8
AD7
This is also demand-pull inflation!
Qu
Q3
Q4
Aggregate Output


The Classical Price Adjustment Mechanism
Price
P_1
AS_1
AD_1
Q_1
Output
Step One


The Classical Price Adjustment Mechanism
Price
P_1
AS_1
Recessionary Gap
AD_2
AD_1
Q_2
Q_1
Output
Step Two


The Classical Price Adjustment Mechanism
Price
AS1
P1
P3
AD2
AD1
Q2 Q3 Q1
Output
Step Three


The Classical Price Adjustment Mechanism
Price
AS1
AS2
P1
P2
AD2
AD1
Q3 Q1
Output
Step Three

The Classical Price Adjustment Failed During the Great Depression

- The Classical price adjustment mechanism did not lift the economy out of the Great Depression.
- To John Maynard Keynes, the problem was this:

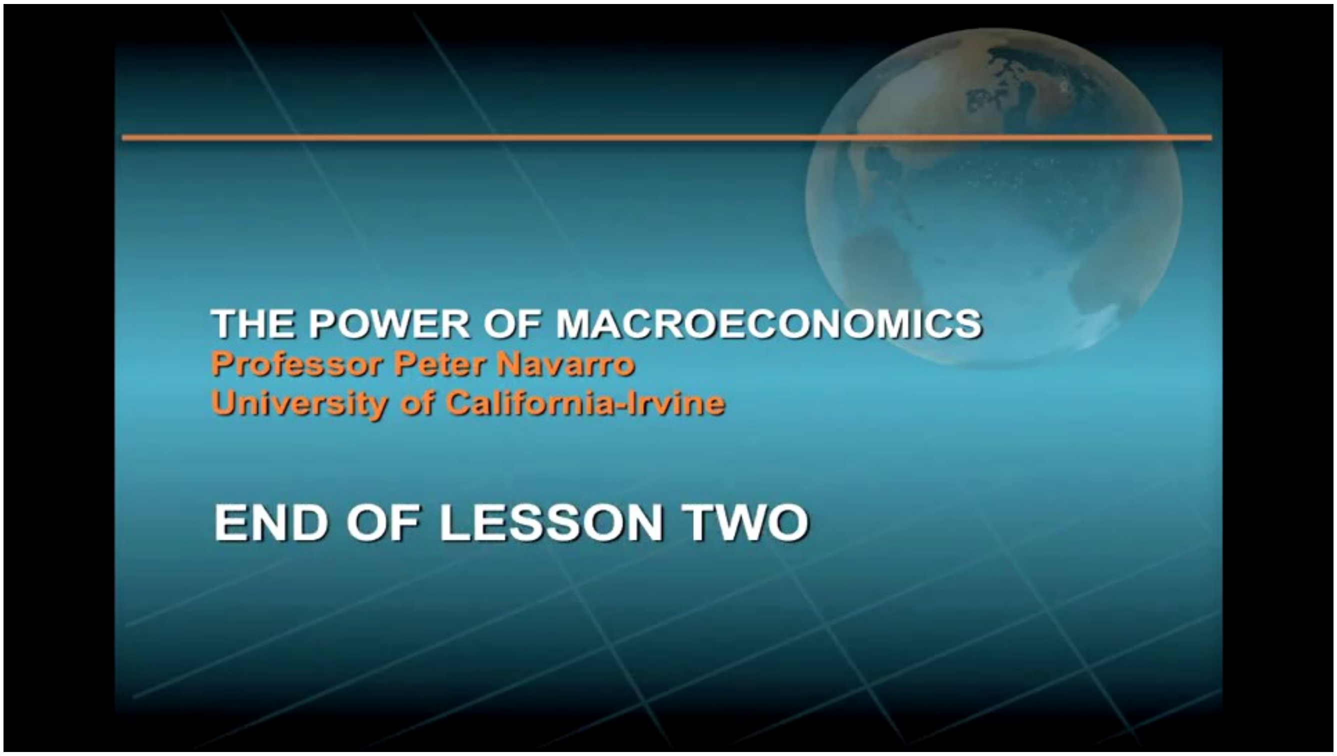
The price adjustments necessary to bring about a recovery were overwhelmed by a much more powerful and deadly "*income adjustment mechanism*."

In The Next Lecture

- Introduce the Keynesian multiplier model.
- Show how the Keynesian model can be used to illustrate a recovery from a recession or depression.

PLEASE REMEMBER

- **Economics is not something to be memorized but rather conceptualized.**
- **As you study it, think about it too!!!!!**


THE POWER OF MACROECONOMICS
Professor Peter Navarro
University of California-Irvine
END OF LESSON TWO