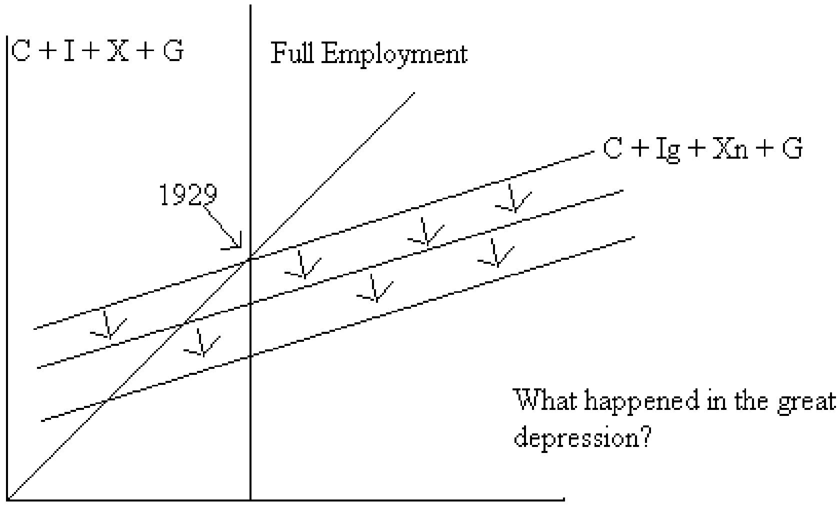
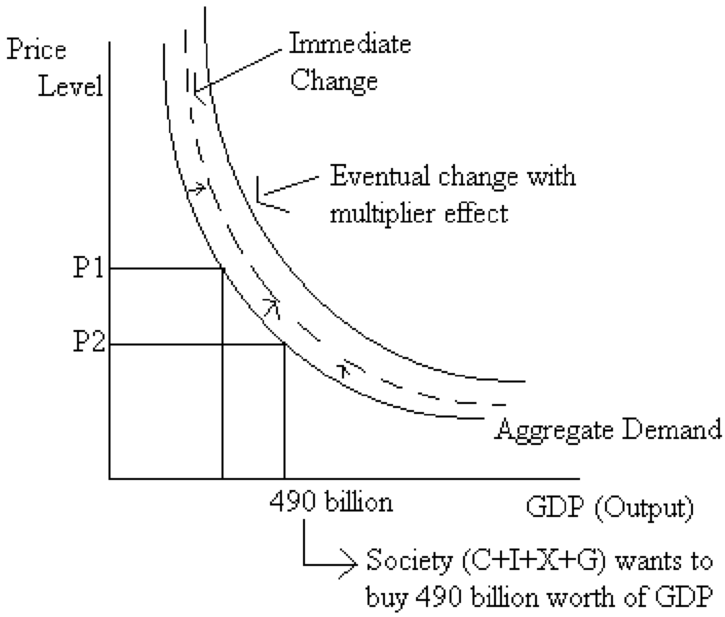
Day 35



- Significant reduction in investment
  - 1929 – 1933 90%
- Equilibrium GDP declined
- Reduction in consumption spending GDP further declined
- Government spending increased with Roosevelt and GDP went up
- 1939, WWII, net exports up
  - Spending went beyond full employment>
  - War ended and government spending went down, but consumers and businesses were poised to spend
- Critics of Keynesian Model
  - Price?
  - Cost push inflation?
- New revised model to explain macroeconomic activity



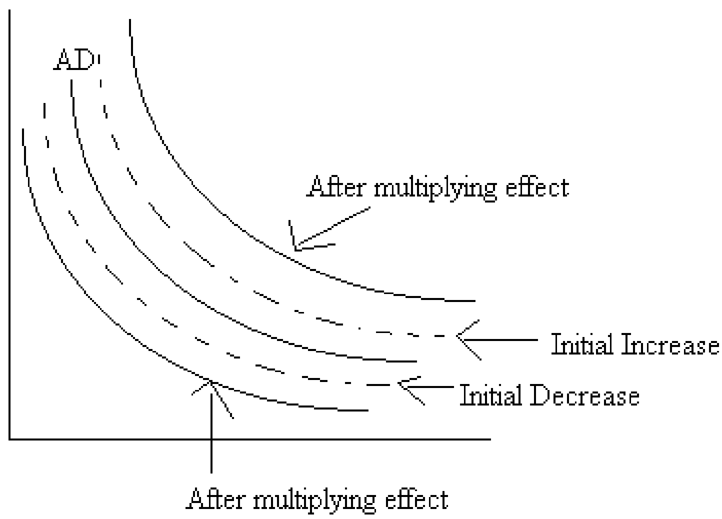
- Price up, amount of GDP society wants to buy goes down and vice versa

- Price Level is the overall or average level of prices

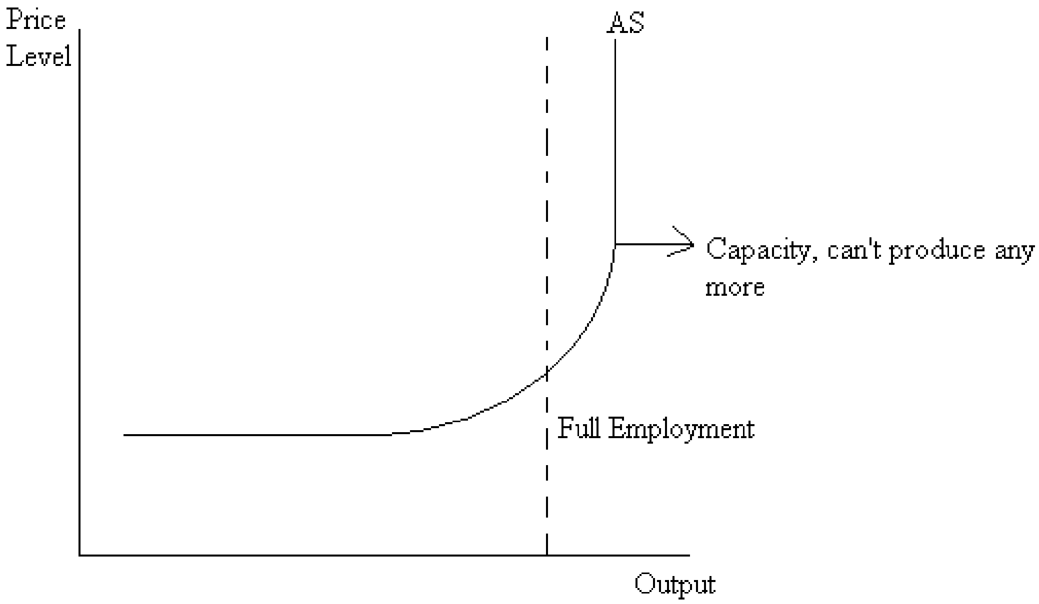
    - If up: Inflation
- On an aggregate level, 3 reasons relationship is true
    - Real Balance – Refer to savings (Prices go down, savings are more valuable)
    - Interest Rate – Prices go up interest rate goes up; effects spending
    - Foreign purchases – American prices go up, Americans buy more foreign goods and foreigners buy less American goods
- As price declines amount of GDP society wants increases

<u>Day 36</u>

- Fact that prices aren't factored into Keynesian Model a serious problem
- AD/AS model
- Aggregate Demand
    - Collective desire of society to buy a certain amount of output
    - Aggregate expenditures is what is actually spent
    - AD is still $C + I_g + X_N + G$
- Inverse relationship between price and aggregate demand
- Shifts in demand… How does that occur?
    - Same as how aggregate expenditures: Same determinants
    - In AD model, multiplying effect is assumed

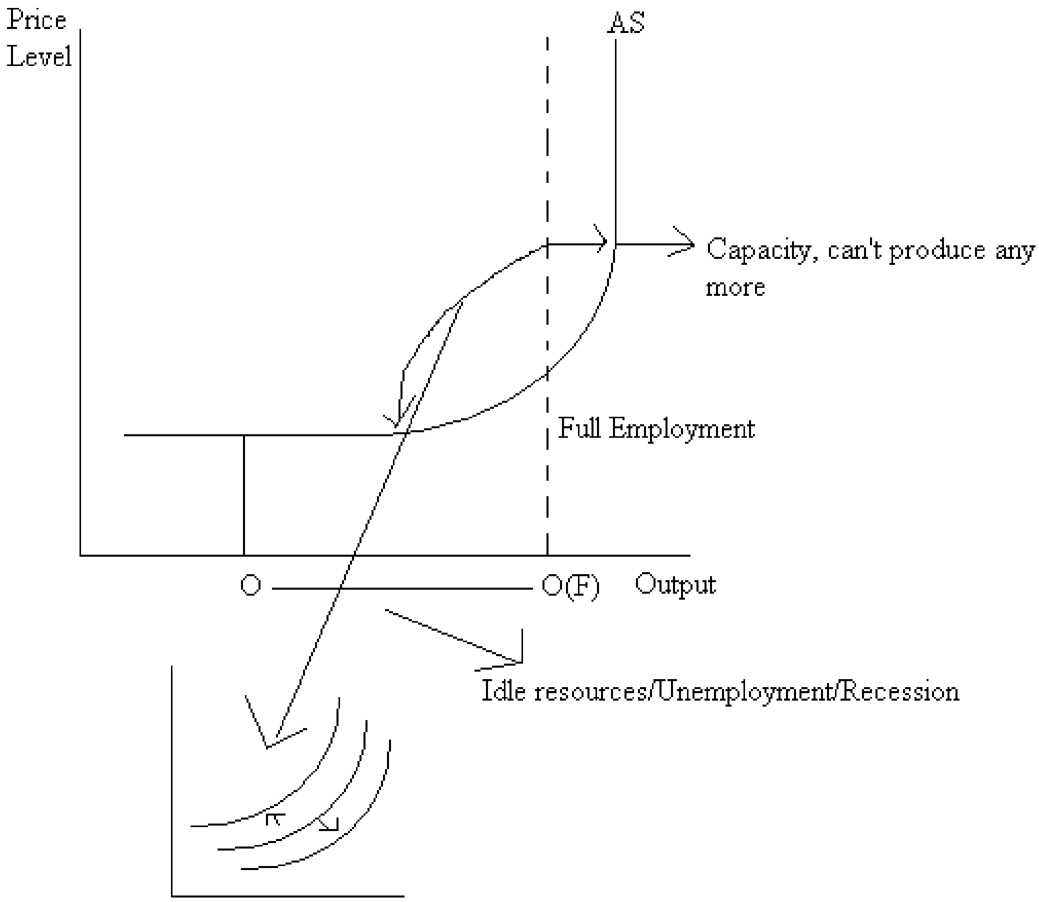


- Aggregate Supply
    - Total amount of production that will be supplied at a particular price level



- Less resources available at full employment – Pressure on price to go up

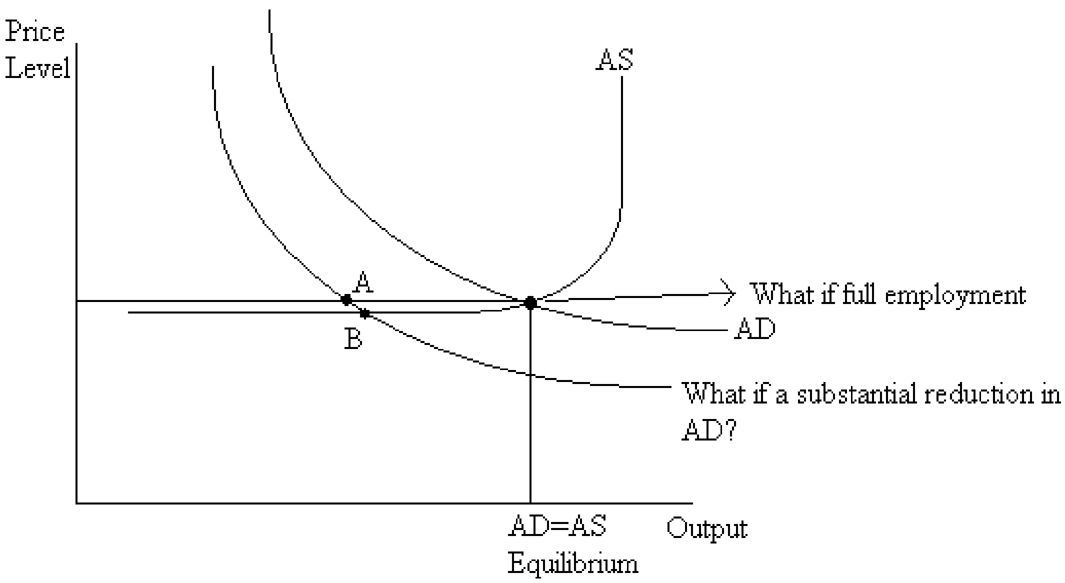
<u>Day 37</u>



- What makes aggregate supply change?
    - Firms may want to produce more or less
        - (can't read my handwriting for this one)
        - Taxes
        - Labor
- If real wages go up, aggregate supply goes down
- Energy cost
- Productivity

<u>Day 38</u>

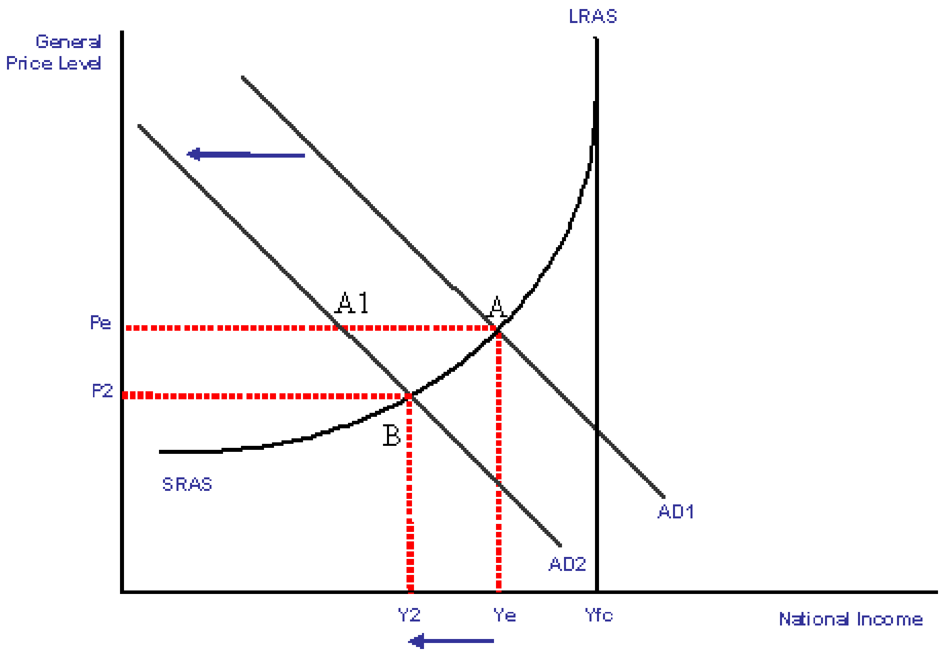
- Per-Unit cost of production
    - Average cost per unit
- As output expands, there is pressure on prices to increase
- What if output and price are the same, what could change the per-unit cost?
    - Real wages
    - Etc
- Productivity – Value of output for a unit in a specific period
- The more productive a laborer is, the more likely to earn wages
- Other things that can affect per-unit cost
    - Taxes regulation



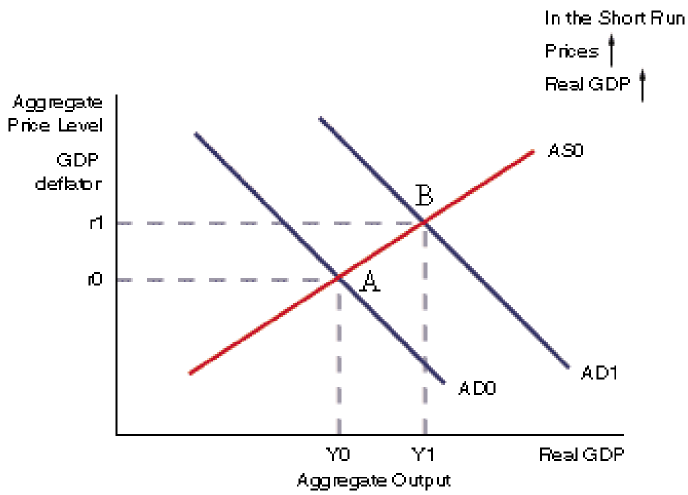
- If reduction in AD
    - Equilibrium does not move to B, but to A
        - Prices typically do not decline

Day 39

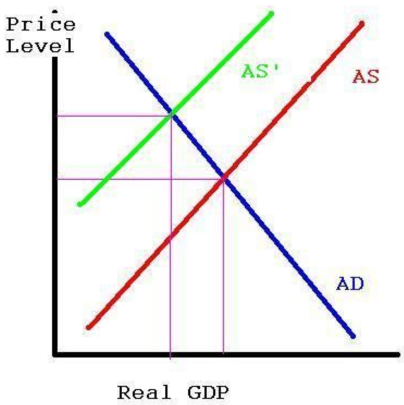
- Level of production and price level are a function of collective desire and amount firms produce
- Decline in AD



- Economic reaction is to go to A1 because prices are sticky downward
- Lower production
- Below full employment
- A - > A1 - > B
- Output expands
- Recession because of lack of demand
- Not enough spending



- Increase in Aggregate Demand
- Equilibrium from A -> B
- Pressure on prices to increase
- Demand pull inflation
- People want to buy more than firms are producing
- Need higher wages… overtime; prices increase (inflation)
- Solution is to reduce demand
- Not full force of multiplier because of increase in prices



- What happens with a reduction in aggregate supply?
  - Output below full employment, prices up
  - Stagflation… some kind of supply shock
  - Does not fit into Keynessian model
  - What to do about stagflation
  - Increase demand: Higher prices

- Decrease demand: Higher unemployment
- Cost Push Inflation

Day 40

- Continuous responsibility to use all means to promote maximum employment, production and purchasing power – Bye-bye Laissez Faire
  - People hold government responsible for economic activities
    - Keynes said problems in economy are because of spending
      - Can the government do something
      - What?
        - Not enough demand -> create more
        - Too much -> create less
          - C + Ig + Xn + G
        - Hard for government to manipulate consumption or net exports
        - Government has control over government spending
        - Fiscal policy
          - A plan for taxation and spending
        - Discretionary Fiscal Policy
          - Take an action based on perception of situation
        - Expansionary Fiscal Policy
          - Increase in government spending and reduction in taxation

Day 41

- What do we expect policy makers to do?
- Employment act of 46
- Keynesian way of thinking allowed for desire of government intervention
- Government can alter taxation or spending
  - Discretionary Fiscal Policy
- Expansionary Fiscal Policy
  - Increase aggregate demand by increasing government spending
- Contractionary Fiscal Policy (for inflation)
  - Reduce government spending or increase taxes
- When revinews = Expenditures; balanced budget
- R < E : Deficit

Day 42

- There is an expectation that the government should take action to fix a problem in the economy
-
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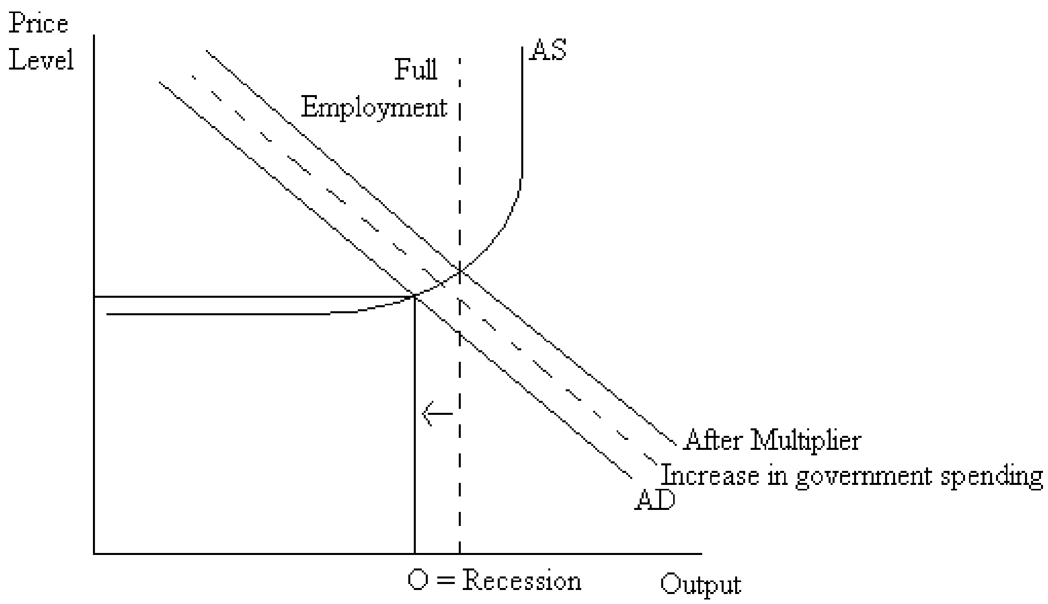
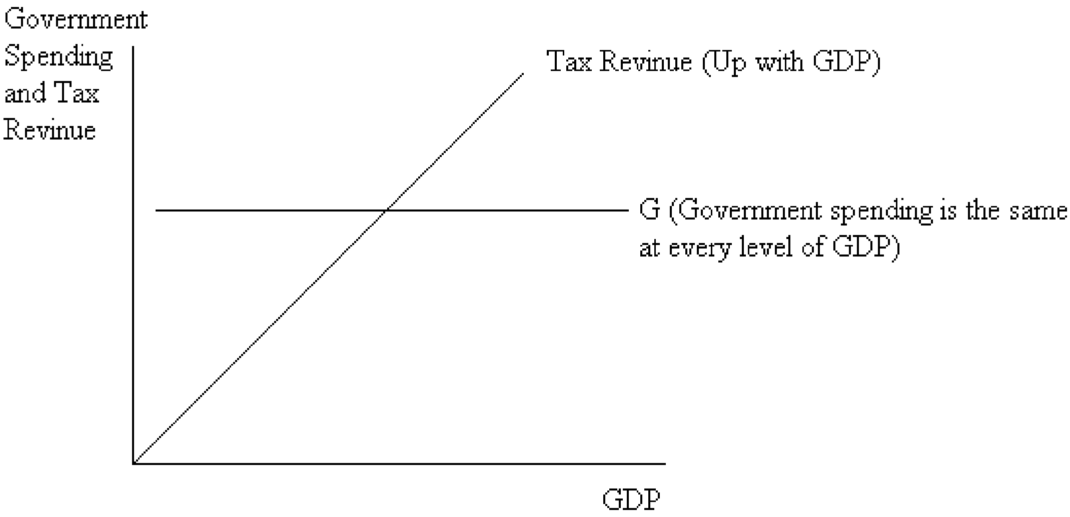


- Recession; Equilibrium is below full employment
- Discretionary expansionary fiscal policy
    - Government alters demand by increasing government spending or decreasing taxes
    - Hope is that the change will multiply creating higher equilibrium
- If expenditures > Revinue, there is a deficit
- Borrow money in order to spend it
    - But… What would the people who loan have done with the money?
- Contractionary Fiscal Policy
    - Surplus: AS/AD intersect above full employment
    - G ↓ T ↑
- People want government to fix the economy, but they want the government to spend less and taxes to go down… o.O this does not work

<u>Day 43</u>

- Difference between automatic stabilization and discretionary fiscal policy
    - Discretionary fiscal policy starts with a problem
    - Recession -> AD too low -> C + Ig + Xn + G -> G↑ or T ↓ -> Deficit
        - Stimulatory/Expansionary
    - Inflation - > AD too high -> C + Ig + Xn + G -> G ↓ or T ↑ - > Surplus
        - Contractionary
    - Discretionary fiscal policy chosen to do
    - With automatic stabilizers; deficit and surplus occur automatically
        - How would that happen?



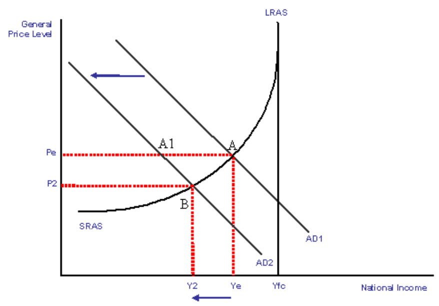
- Tax Progressivity – Have a progressive tax on national level
  - The more someone makes; the more they pay
  - Income goes up, percent goes up as well
  - Every American that earns income is liable to pay tax on that income
    - Total Income = Wages + Interest + Profit + Rent
    - Taxable Income = Total Income – Deductions (Charitable contributions, pensions, interest on mortgage)

Day 44

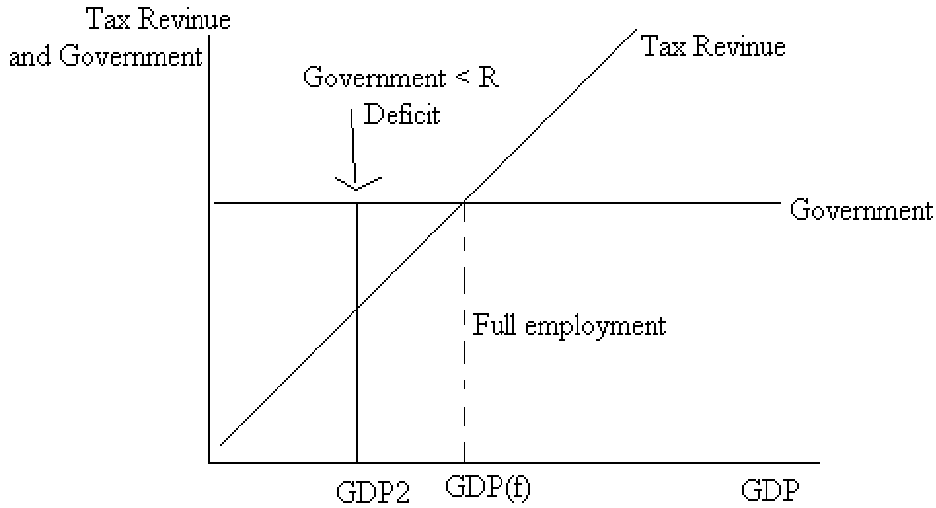
- Automatic stabilization is based on progressive taxation
- When figuring taxes
- Gross income first; then figure taxable income
- More you make, the greater taxation liable for

Day 45

- Progressive tax scale important to fiscal policy
- What if AD declines significantly



- Discretionary fiscal policy
    - Increase government spending or decrease taxes -> Deficit (R < E)



- Why the automatic deficit?
    - Revenue declined
- Why did tax revenues fall?
    - Income goes down when GDP goes down
    - Percentage and amount of income taxes all go down
- This is an automatic stabilizer
    - People paying less taxes, and government paying a lot (Natural [cyclical] budgetary deficit)
- With discretionary fiscal policy
- Amount of government spending exceeds revenue at full employment – structural deficit
    - Our deficit partially structural and partially cyclical
- To contract deficit raise taxes and decrease government spending
    - But takes back into recession does it not?

<u>Day 46</u>

- What are the problems associated with fiscal policy?

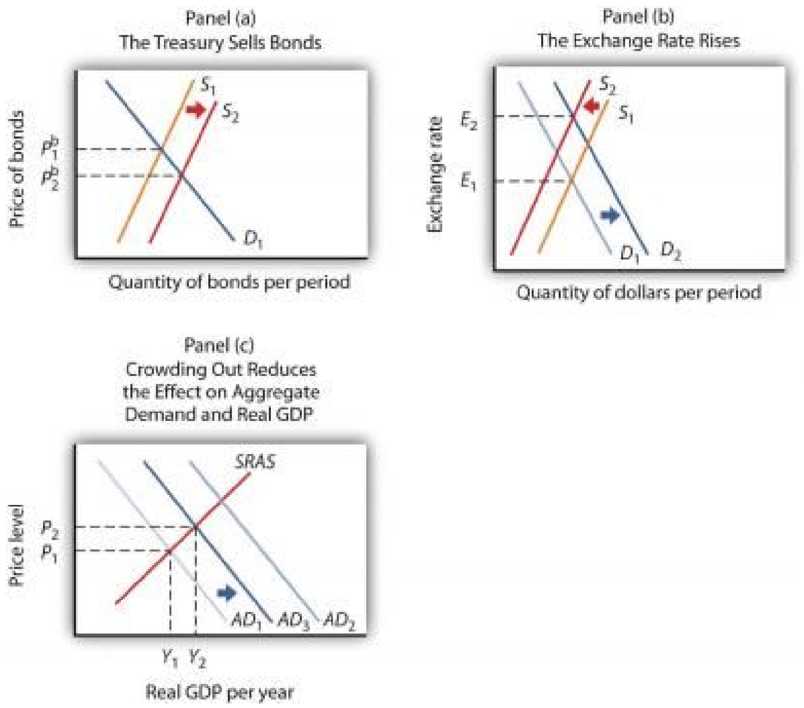
<u>Day 47</u>

- Public expects government to do something about economic problems
- Fiscal policy is altering demand to stabilize economy at full employment
    - Too much or too little spending
- Automatic stabilization
    - Some say fiscal policy is not effective
        - 2 Major criticisms

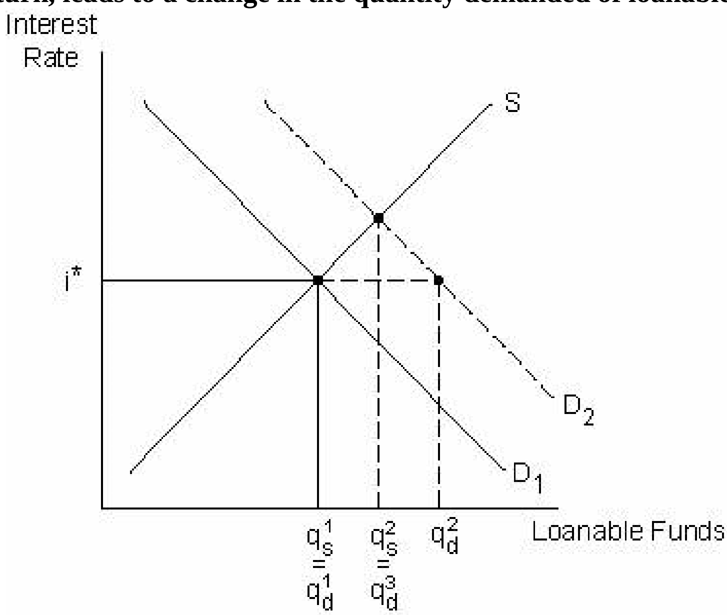
- Lags (Slow things down)

Day 48

- Limitations of fiscal policy
    - Lags
    - Crowding out
        - Expansionary fiscal policy should expand
        - Contractionary fiscal policy should contract
        - Key to crowding out is interest rates
            - If the government wants a large amount of savings, cause price of savings to go up… higher interest rates with large government spending… negates expansionary effect?
        - Government spending crowds out private spending
- Defenders say that there is nothing to crowd out
- High interest rates that could result from budgetary deficit can affect net exports
    - Net export effect
        - Value of a currency is a function of what you can do with the currency
        - High interest rates mean that the demand for the dollar goes up
            - High interest rates attract foreign investment
            - Net exports go down
            - Weak dollar is good for net exports
                - Net export effect
                - Interest ↑ $ ↑ Xn ↓
                - Interest ↓ $ ↓ Xn ↑
            - Another limitation of fiscal policy
    - Recognition Lag (needs to be concensus that there's a problem – Party in power in denial)
    - Administration Lag (Making a policy… getting it done)
    - Operational Lag (How long it takes between when a problem occurs and meaningful action)
    - Crowding out ↓



- Structural deficit: At full employment government spending more than taking in
- **A change in the interest rate leads to a change in the demand for loanable funds which, in turn, leads to a change in the quantity demanded of loanable funds.**



- Yeah ☺ I really got sick of drawing those graphs
- When the government wants to borrow money, it takes from savings (Savings bonds)
- Demand for loanable funds sky rockets
- Real interest rates go up
- Increase in interest rates could crowd out effects of fiscal policy

- Most serious criticism of fiscal policy
- Renders it useless
- Defenders of fiscal policy say that there will be no pressure because demand for loanable funds would go down
- National Debt
    - Securities in hand of someone
    - All of budgetary deficit in US history – Surpluses
    - Should the debt be added to?
    - Budgetary Philosophy
        - Should government balance budget every year?
        - 98% of economists say no
        - Balancing budget annually would make the business cycle worse

<u>Day 49</u>

- National debt rolls over
- When a bond is cashed in, it is immediately resold to someone else
- Is debt bad?
- R < E Budgetary deficit
- R = E nothing added to debt
- Argument against balancing budget
    - Can't balance budget with deficit with fiscal policy
- People that advocate balancing budget annually: Small government
- Some suggest cyclically balanced budget
    - Not viable
- Functional finance perpetuates debt
- Big misconception about debt is that it has to be payed
    - Can have debt forever!!!!!!

<u>Day 50</u>

- National debt percentage of GDP
- 3 Reasons debt is accumulated
    - War
    - Deficits
    - Fiscal Irresponsibility
- Problems with debt
    - Interest
        - 3rd largest expenditure in national budget
    - Redistribution
    - Crowding out
    - What could we have done with the money
        - Burden on future generations is opportunity cost

        - If the government spends a dollar, somebody else could have
- Functional Finance
    - Budgetary Philosophy don’t care about budgetary balance
        - Get full employment
- Study things that affect AD and AS -> Things that affect production wages, productivity, energy cost, regulation tax