Chapter 9: Economic Fluctuations

- Classical Model
  - Economic growth
    - Full-employment output rises steadily
  - Employment, output, spending

- Business cycles
  - Recessions, expansions, booms
  - Causal relationship between employment and output
    - Good reason to conclude that output $\rightarrow$ employment
Verdict: Classical Model cannot explain Economic Fluctuations

- Booms or recessions are caused by sudden & significant shifts in either $L^D$ or $L^S$
  - Very unlikely
- Recessions
  - $L^D$ shifts: less productive workers ($K \downarrow$)
  - $L^S$ shifts: change in preferences
    - Conflict with real world events
- Booms
  - $L^D$ shifts: more productive workers ($K \uparrow$)
  - $L^S$ shifts: change in preferences
    - Conflict with real world events
Economic Fluctuations

- S/R economic fluctuations cannot be explained with a model in which labor market always clears

- What triggers fluctuations?
  - Simple sense
    - Breakdown of communication & coordination
    - Production decisions are made long before spending
      - Expectations are important
      - Other causes
Recent Expansions & Recessions of U.S.

- Recession of 1981-82
  - Change in Federal Reserve Policy
    - $I^p \uparrow$
- Expansion of 2002-?
  - Changes in FED policies and fiscal policies
    - $C \uparrow$
- In the S/R
  - Changes in spending affect production
    - Affect employment level