Chapter 36 McConnell, Brue and Flynn 20th

Extending the Analysis of Aggregate Supply

During the early years of the Great Depression, many economists suggested that the economy would correct itself in the long run without government intervention. To this line of thinking, economist John Maynard Keynes remarked, “In the long run we are all dead!”

For several decades following the Great Depression, macroeconomists understandably focused on refining fiscal policy and monetary policy to smooth business cycles and address the problems of unemployment and inflation. The main emphasis was on short-run problems and policies associated with the business cycle.

But over people’s lifetimes, and from generation to generation, the long run is tremendously important for economic well-being. For that reason, macroeconomists have refocused attention on long- run macroeconomic adjustments, processes, and outcomes. The renewed emphasis on the long run has produced significant insights about aggregate supply, economic growth, and economic development. We will also see in the next chapter that it has renewed historical debates over the causes of macro instability and the effectiveness of stabilization policy.

This chapter and the next will follow the topics listed under the Stabilization Policies on the AP Macroeconomics Course Outline. The focus on stabilizing the macroeconomy and the model of the Phillips curve stresses long-run policies, which extend Aggregate Demand and Supply theory. Our goals in this chapter are to extend the analysis of aggregate supply to the long run, examine the inflation-unemployment relationship, and evaluate the effect of taxes on aggregate supply.