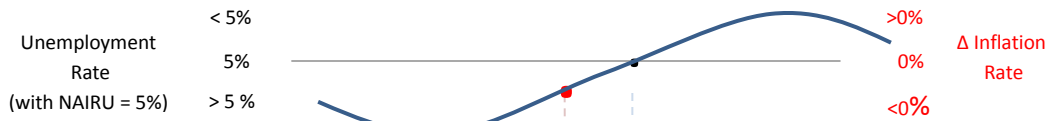


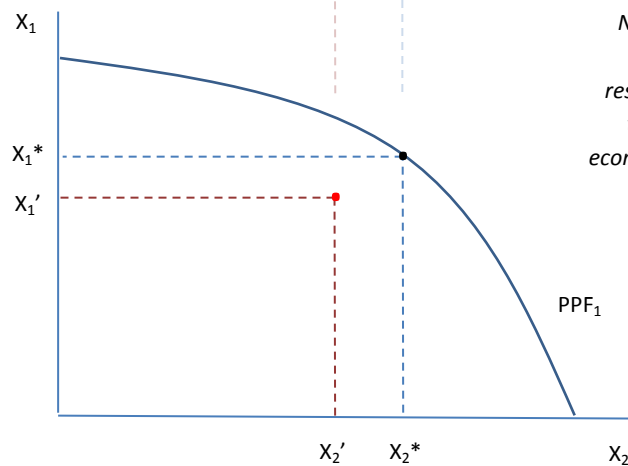
NAIRU, Business Cycle, PPF, and AS-AD Model Integration¹

Instructional Primer²

Consider how the NAIRU, Business Cycle, PPF, and AS-AD Models might be connected – all through the labor market of course. The following represents a labor market in which unemployment is above the NAIRU and lets us see how this might effect a nation’s PPF and how these are reflected in the AS-AD Model.

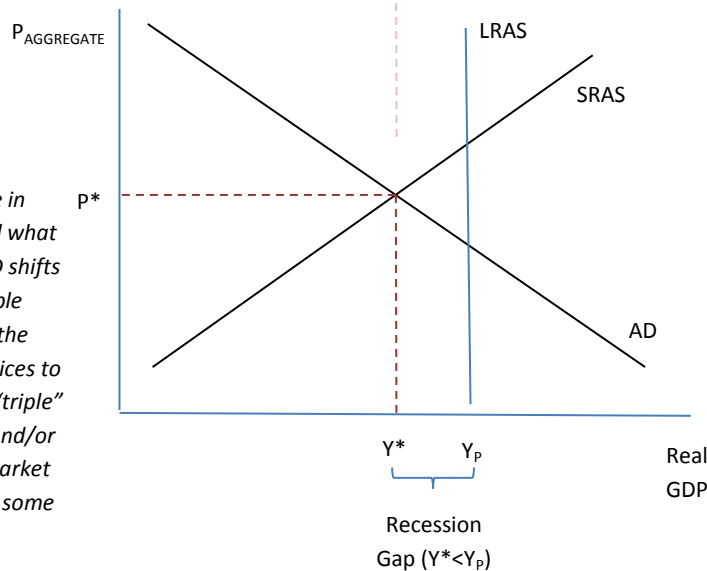


Inefficient production not only puts pressure on businesses and households in the current period, but also holds them back in future periods through decreased capital investment and hysteresis (skills depreciation due to lingering unemployment)



Notice how unemployment represents an inefficient use of a nation’s productive resources and results in production inside of the PPF. We would expect this to make economic growth more difficult and put inward pressure on the PPF in future period(s)

Consider the effect of an increase in Aggregate Demand (not shown) and what that might mean for price level. If AD shifts to meet both SRAS and LRAS (triple tangency) then we would expect the economy, employment levels, and prices to stabilize. But if AD shift beyond the “triple” tangency”, we might expect prices and/or employment to rise such that the market experiences a boom, preparatory to some future bust.



We might expect this to be coincident with a period of recession, as shown. Think about potential fiscal or monetary policy actions that may be employed to help “steer” the economy away from such a recession or just the opposite, a possible period of inflation. Would the easing of pressure on businesses and households be worth the potential costs?

¹ This primer is intended to present an abbreviated discussion of the included economic concepts and is not intended to be a full or complete representation of them or the underlying economic foundations from which they are built.

² This primer was developed by Rick Haskell (rick.haskell@utah.edu), Ph.D. Student, Department of Economics, College of Social and Behavioral Sciences, The University of Utah, Salt Lake City, Utah (2014).