

Chapter 25 Project

The Aggregate Demand/Aggregate Supply Model

Purpose

In this chapter, you have learned how the aggregate demand/aggregate supply (AD/AS) model is constructed. The AD/AS model demonstrates how the price level and gross domestic product (GDP) are determined and how fiscal policy (changes in taxes and government spending) can be employed to influence macroeconomic outcomes.

The purpose of this project is to analyze the economic effects of recent recessions and the U.S. government's responses to them.

Directions

This project has three parts. In the first, you will evaluate how consumption and investment were affected during the Great Recession and how the drop in these two variables combined to reduce AD.

In the second, you will summarize the final impact such changes had on the following macroeconomic variables and indicators: real GDP, changes in the price level (i.e., the inflation rate), the unemployment rate, and the consumer and business confidence indices.

In the third, you will analyze the macroeconomic impacts of the CARES Act and how this compared to the governmental policies enacted during the Great Recession.

Part 1 - Evaluating the Macroeconomic Conditions of the Great Recession and the COVID-19 Recession

The Great Recession was the economic downturn in the U.S. from 2007 to 2009 that occurred as the result of a burst housing bubble and financial crisis, and the COVID-19 recession was the brief yet sharp economic downturn in 2020 resulting from the COVID-19 pandemic. The following links provide a graphic representation of the trends of different components in the U.S. economy. Pay attention to the data for years leading up to and during both recessions.

1. Real personal consumer expenditures

At this webpage (hawkes.biz/PCEC), examine the trends in real personal consumption expenditures from 2006 to 2022. Set the dates of observation as 2006 to 2022.

2. Consumer confidence in the U.S.

At this webpage (hawkes.biz/CI), examine the trends in consumer confidence in the U.S. from 2006 to 2022. Set the dates of observation as 2006 to 2022.

3. Real gross private domestic investment

At this webpage (hawkes.biz/GPDI), examine the trends in real gross private domestic investment from 2006 to 2022. Set the dates of observation as 2006 to 2022.

4. U.S. business confidence vs. global average

At this webpage (hawkes.biz/BCI), examine the comparison of business confidence in the U.S. versus the global average. Set the dates of observation as 2006 to 2022.

5. Inflation rate

At this webpage (hawkes.biz/ICP), examine the inflation rate for consumer prices in the U.S. Set the dates of observation as 2006 to 2022.

After you review all the data, explain the dramatic changes that occurred in each of these variables in the year preceding the Great Recession (2006), during the Great Recession, and in the years of recovery immediately following the Great Recession (2010–2016). Do the same for the year preceding the COVID-19 recession (2019), during the COVID-19 recession (2020), and the years after the COVID-19 recession (2021–2022). Is this consistent with the idea that negative information/economic conditions feed on themselves and make the situation worse?

If so, how? Be specific in your explanation. Be sure to support your explanation with evidence from each of the economic indices.

Part 2 - How the U.S. Government Used Fiscal Policy to Combat the Great Recession

The Obama administration developed the American Recovery and Reinvestment Act of 2009 (ARRA) in response to the Great Recession. The following two articles describe the goals and the effect of the stimulus package: (hawkes.biz/ARRA1) and (hawkes.biz/ARRA2).

Using evidence from the articles, explain and assess the effectiveness of the fiscal policy measures undertaken by the Obama administration during (and in the immediate years following) the Great Recession.

Second, within the context of the AD/AS diagram, demonstrate the impact of the aforementioned policies on AD and the resulting changes in the price level (that is, the inflation rate) and GDP. (*Note: Use Figure 5 in Lesson 25.1 as your starting point for the graphing portion of this exercise. Recall that expansionary fiscal policy would cause the AD curve to shift right, demonstrating an increase.*)

Part 3 - Evaluate How the U.S. Government Used Fiscal Policy to Respond to the COVID-19 Recession

The Trump administration developed the Coronavirus Aid, Relief, and Economic Security (CARES) Act in response to the economic turmoil resulting from the 2020 COVID-19 pandemic. The scope of this act was staggering, distributing over \$2 trillion of federal funds to families and firms across the United States. The following two articles discuss the macroeconomic impact on the country: (hawkes.biz/CARES1) and (hawkes.biz/CARES2).

Using evidence from the articles, discuss the short- and long-term effects of the CARES Act on both unemployment and GDP.

Explain how changes in aggregate demand or aggregate supply incited the government to pass the CARES Act.

Next, explain how changes in aggregate supply and aggregate demand were different during the COVID-19 recession than they were preceding the American Recovery and Reinvestment Act of 2009.

Checklist

Part 1

- ☐ Develop an understanding of the following macroeconomic variables: consumer expenditures, investment expenditures, consumer confidence, business confidence, the inflation rate, and the business cycle.
- ☐ Investigate the provided data.
- ☐ Analyze the changes that occurred in macroeconomic variables before, during, and after the Great Recession and the COVID-19 recession.
- ☐ Interpret the impact that negative information/economic conditions have on behavior.

Part 2

- ☐ Read the articles provided.
- ☐ Describe, explain, and assess the effectiveness of ARRA.
- ☐ Using the AD/AS diagram, evaluate the impact ARRA had on AD and the resulting impact on changes in the price level and GDP.

Part 3

- ☐ Read the articles provided.
- ☐ Explain the governmental incentives to pass the CARES Act.
- ☐ Compare the CARES Act to ARRA.