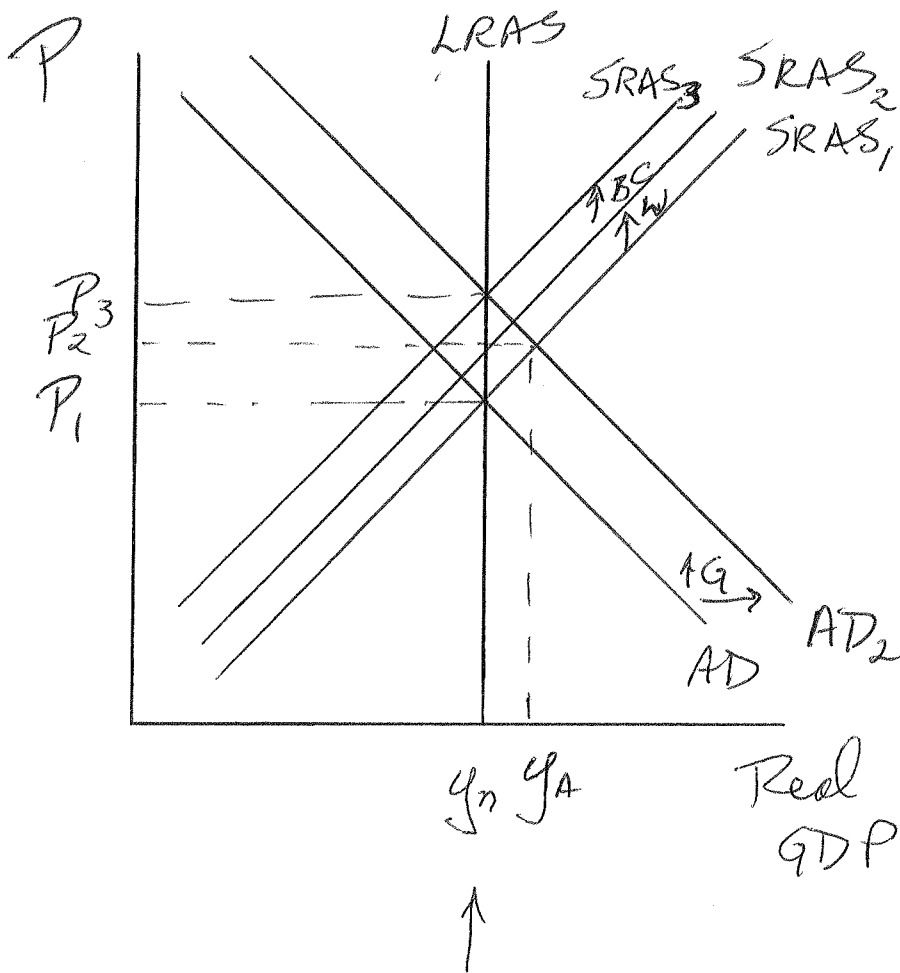


FISCAL POLICY LAGS

INCREASE GOV'T SPENDING &/or DECREASE TAXES
IN RECESSIONARY GAP

⇒ AT LR EQUILIBRIUM DUE TO LAGS SO CAUSES



AN EXPANSIONARY GAP!

$$Y_A > Y_n$$

HIGHER P LEVEL
& $u_p < \text{NAT RATE}$

SO WAGES INCREASE
BUSINESS COSTS INCREASE

PRICE EXPECTATIONS GO UP.

SRAS SHIFTS LEFT OVER TIME TO L.R EQUILIBRIUM

SRAS₂ & SRAS₃

POTENTIAL REAL OUTPUT & NATURAL RATE OF UNEMPLOYMENT

* PRICES INCREASE

* UNEMPLOYMENT BACK AT NATURAL RATE

* REAL GDP FALLS BACK TO POTENTIAL REAL GDP