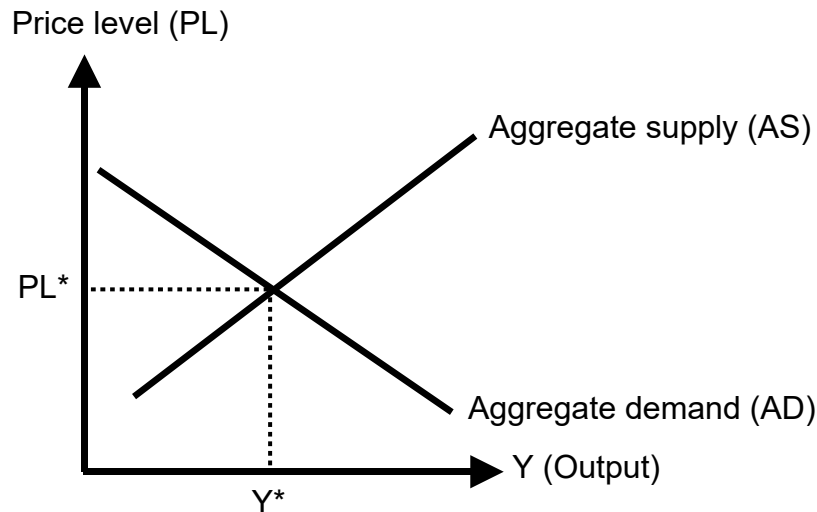
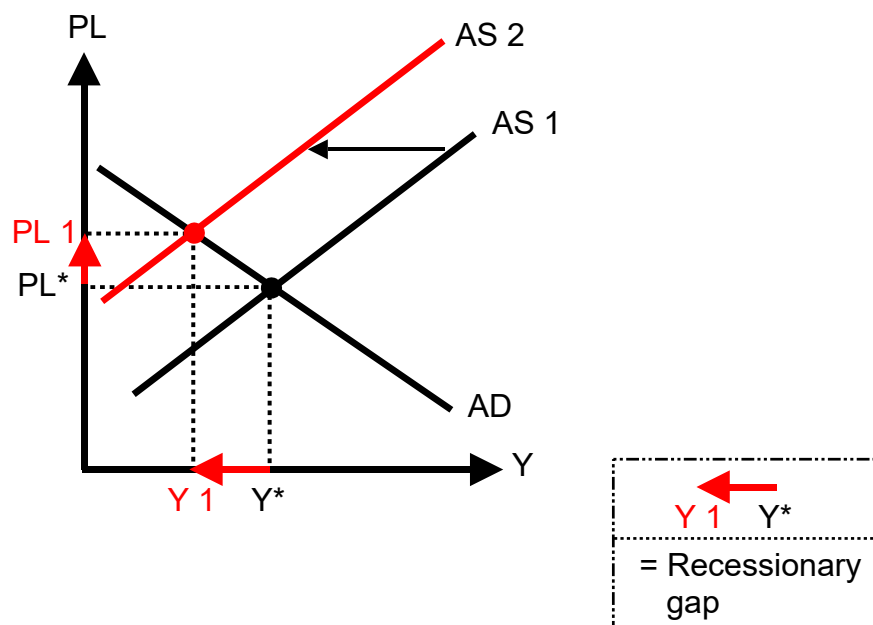


# Stagflation

- 1 The starting point is an economy enjoying **full employment** ( $Y^*$ ):



- 2 Now a **supply-side shock** takes place (for example a substantial rise in the price of oil):



- 3 The supply shock results in a **stagflation**, that is in a combination of inflation ( $PL 1 > PL^*$ ) and recession ( $Y 1 < Y^*$ ).

4 There is **no easy way out** of a stagflation.

<p>41 The fiscal policy (for example a rise in government spending) does not work satisfactorily:</p>	<p>42 The supply-side economics (for example cutting a tax paid by firms to improve incentives to supply more or legislating against monopolies) can possibly work:</p>
<p>Full employment (<math>Y^*</math> instead of <math>Y_1</math>) can be restored by measures of fiscal policy, but only at the price of even more inflation (<math>PL_2 &gt; PL_1</math>).</p>	<p>Unemployment and inflation can be tackled simultaneously.</p>